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DOES REGIONAL GOVERNMENT SPENDING BOOST ECONOMIC GROWTH: IN AN ERA OF FISCAL DECENTRALIZATION?

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ABSTRACT: This study aims to analyze regional expenditure and its impact on increasing economic growth. The method used in this study is a simultaneous equation model, using panel data for district and city in East Java, Indonesia. The findings of this study that regional expenditure has a positiv effect on the level of regional economic growth, which means that regional expenditure has a significant positive effect, if regional expenditure is increased, this will encourage an increase in the level of economic growth.

KEYWORDS: regional expenditure, economic growth, simultaneous model

I. INTRODUCTION

East Java economic growth is faster than national economic growth. The contribution of East Java's gross regional domestic product (GRDP) to the national gross domestic product (GDP) reached 14.61 percent. Therefore, the province of East Java has a very important position in the national context as the main economic supporter. However, a high economy in an area does not always reflect the well-being of all people, (Todaro, 2000). East Java regional economy performance is focused on economic growth. Among these indicators used to measure the development of the well-being level of the people in an area is an indicator of economic growth (Regulation, 2010). East Java development should position regional spending as a tool to accelerate the delivery of inclusive economic growth. This phenomenon has sparked public attention in studies of increasing economic growth through regional spending. Based on empirical studies, regional expenditure is one of the variables believed to stimulate economic growth. Much research has been done on regional spending, but little research has been done on increasing economic growth through regional spending, especially in East Java. According to (Todaro, 2000), prosperity is not only limited to basic needs, namely clothing, food and shelter, but also other needs to improve the quality of human life, such as education and health. Economic growth is an indicator of regional economic performance (World, 2014). There is a great relevance between the level of government expenditure with economic growth, the number of unemployed and the poverty level. Total public spending plays a role in stimulating economic growth, the level of poverty can be reduced by increasing capital and commodity expenditure, as this will increase people's productivity and purchasing power and ultimately reduce poverty (Indonesia, 2011). An Analysis of Moderation Interaction between Regional Expenditure with Economic Growth and Population Level Working in Reducing Poverty. As a result, high economic growth and high levels of population work have a significant effect in reducing poverty; Regional spending strengthens the effect of economic growth and the level of population employed in reducing poverty, (Nugroho, 2017). Various studies have not yet seen research that discusses in detail about increasing economic growth through regional spending in East Java. Based on the above description, the problem can be formulated as follows: Can regional expenditure increase economic growth in districts and cities in East Java, Indonesia? This study aims to analyze the impact of regional spending on increasing economic growth. The results of this study are expected to be a reference for policymakers in the province of East Java in general and in the regional governments of regencies / cities in East Java in particular with regard to enhancing economic growth through regional expenditure.

II. LITERATURE REVIEW

Fiscal decentralization policy

Fiscal policy is aimed at increasing the well-being of the community by increasing economic growth, expanding employment to reduce unemployment, fighting poverty and fighting inflation (Ministry of Finance of the Republic of Indonesia, 2009). Tax policy is an economic policy that aims to better control economic conditions by changing government revenues and expenditures, (Pakpahan A.T, 2002). The regional fiscal policy of Regency / city in East Java is expected to stimulate the regional economy in a sustainable and high-quality way. Regional tax variables include regional income and expenditure. Regional autonomy policy and fiscal decentralization policy are aimed at accelerating people's well-being, (Ministry of the Interior, 2013). The concept of autonomy (Todaro, 2000) General competence for districts / cities; (Regulation, 2010). The division of powers takes place between the provincial and provincial/regional governments (World, 2014) The subsidiarity principle applies (simultaneously) in authority in all areas and can be divided between levels of government, (M. Kuncoro, 2013). The fiscal decentralization policy relates to government revenues and expenditures, so government expenditures are part of fiscal policy. The adoption of a fiscal decentralization policy prioritizes the full transfer of expenditure, with local governments increasing regional expenditure as a strategy to boost economic growth. Tax decentralization in a region can be measured by two variables, namely regional income and expenditure. These indicators are used by previous researchers such as (H. Kuncoro, 2004) and others. Referring to the variables used by previous researchers and the theoretical basis, the researcher concludes that the indicator of fiscal decentralization can be seen in terms of regional income and expenditure. Under Law No 33 of 2004, those sources of regional revenue in the context of the implementation of regional autonomy and to finance regional budget for income and expenditure include: (Todaro, 2000) local original destination fund, (Regulation, 2010) balance funds, (World, 2014) other legitimate regional revenues, (Ministry of the Interior, 2004). The government expenditure is part of fiscal policy, which is a government action to regulate the economy by determining the amount of government revenue and expenditure each year, which is reflected in the national budget and the regional budget, (Sukirno, 2013). Referring to (Minister of the Interior, 2007), the regional expenditures based on the group consist of indirect and direct expenditures.

New or endogenous economic growth

The theory of endogenous growth explains that economic growth is a process that originates from within a system, (P. Romer, 1994). Three main elements in the Romer model are (Todaro, 2000) the existence of an externality element as a result of scientific progress, (Regulation, 2010) an increase in the scale of results that increases, increasing specialization and division of labor, (World, 2014) the shorter time for the use of science, because rapid development in the research sector. In general, the Romer model is formulated as follows: Yi = A Kiα Li 1-α Kβ, where: Yi is the production output of company i, Ki is the capital stock, Li is labor, A is the total stock of technical knowledge. A is believed to have a positive spread effect on production in any business. The endogenous growth model was developed based on three ideas: (Todaro, 2000) *(1)* Declining capital returns are eliminated by the knowledge spillovers generated by investments, assuming knowledge stocks will increase with investments by learning by learn busy with process (P. M. Romer, 1986); (Regulation, 2010). *(2)* There are two sectors namely physical capital and human capital production sector, human capital production can improve technology and cover losses due to falling physical capital return (Lucas, 1988); *(3)* Technological progress is endogenously determined by new ideas from the results of research and development, (P. Romer, 1994). The concept of fiscal decentralization in the context of the theory of endogenous economic growth, and in 1990 built a model based on an endogenous economic growth model and distinction between private investment and public investment, with an economic growth model that yields constant returns. Government revenue comes from taxes with a balanced budget. An increase in government spending is followed by an increase in taxes and vice versa. Public expenditure development refers to endogenous growth theory, with public expenditure being the primary tool for economic growth, (Barro, 1990)

III. PUBLIC EXPENDITURE

The macro theory of government expenditure has been developed by Wagner in his theory "The Law of Expanding State Expenditure", which states that if per capita income in the economy increases, government expenditure will increase, (Mangoesoebroto, 2010). Government spending reflects government policy. If the government has established a policy to buy goods and services, government expenditure reflects the costs that the government must incur to implement the policy (Mangoesoebroto, 1996).

The relationship between government spending and economic growth is theoretically explained in Keynesian Cross, Local government expenditures are the value of local government expenditures used for the benefit of the community. Public expenditure in terms of indirect expenditure is expenditure not used directly by the program. Public expenditure in terms of direct expenditure is expenditure used for planned programs and activities. Local government expenditures are the value of local government expenditures used for the benefit of the community. Public expenditure in terms of indirect expenditure is expenditure that is not directly used by the existence of the program, it plays an important role in supporting the smooth mechanism of the public system and efforts to increase efficiency and productivity, so that the goals and objectives of each development phase are achieved. Indirect expenditure includes personnel expenditure, interest expenditure, subsidy expenditure, subsidy expenditure, social assistance expenditure, profit sharing expenditure, financial aid expenditure and unexpected expenditure. Public expenditure in terms of direct expenditure is expenditure used for planned programs and activities. These direct expenditures are expenditures intended to increase community capital in the form of physical and non-physical development. Direct expenditure is intended to finance development programs, so that the budget is adjusted to the resources that have been successfully released. Direct expenditure is total direct expenditure, including personnel, goods and services, and capital expenditure.

Various studies of government expenditure with economic growth have been conducted and used as a reference, including: (Mankiw, 2003), Local Government Planning and Budgeting Processes: Cases of regency and Cities in east java, Indonesia. The result: that since the implementation of fiscal decentralization, the role of regional governments has been greater in determining planning and budgeting. In general, the coherence of local and national planning has a relatively high priority. However, there is little consistency between regional development work plan and regional budget for revenue and expenditure plan, both in budget formulation and program execution. The role of government expenditure in the region for economic growth. The result: public expenditure has a direct positive effect on regional economic development, but not all indicators have a direct effect. Indirect effects occur on the expenditure of the education and health sector, but indirectly, the expenditure of the infrastructure sector has no significant effect on regional economic development. This means that an increase in government spending tends to increase economic growth through indicators of regional economic development in education and health, but not through regional infrastructure development indicators, (Khusaini, 2014). The analysis of moderation interactions between regional expenditure with economic growth and population level working on poverty reduction. As a result, high economic growth and a high population have a significant effect on poverty reduction; Regional spending enhances the effect of economic growth and the population working to reduce poverty, (Khusaini, 2016). The impact of government spending and efficiency on economic growth in Indonesia. It has been found that an increase in government spending will increase economic growth in the districts and cities of Java, Indonesia, (Faisol, 2018). The Government Spend, Economics growth Development Rate on Income of Kolaka Regency. It has been found that the ratio of routine expenditure harmony has a positive and significant effect on the economic growth of the Kolaka Regency Government. The existence of a significant effect is due to the use of spending can have a multipler effect on the regional economy. (Regulation, 2010) The harmonization ratio of development spending has a positive and significant effect on the economic growth of the Kolaka Regency government. This is because the allocation of development spending can encourage economic activities so as to create economic growth (Zulkarnain, Mus, & Sudirman, 2020).

Model

At this stage, econometric models of simultaneous equations consist of structural and identity equations. The General Model of Simultaneous Equations is (Gujarati, 2009).

$$Z_{1t} = \alpha_{12} Z_{2t} + \alpha_{13} Z_{3t} + \ldots\ldots + \alpha_{1M} Z_{Mt} + \beta_{11} X_{1t} + \beta_{12} X_{2t} + \ldots\ldots\ldots + \beta_{1K} X_{Kt} + \delta_{1t}$$
$$Z_{2t} = \alpha_{21} Z_{1t} + \alpha_{23} Z_{3t} + \ldots\ldots + \alpha_{2M} Z_{Mt} + \beta_{21} X_{1t} + \beta_{22} X_{2t} + \ldots\ldots\ldots + \beta_{2K} X_{Kt} + \delta_{2t}$$
$$Z_{3t} = \alpha_{31} Z_{1t} + \alpha_{32} Z_{2t} + \ldots\ldots + \alpha_{3M} Z_{Mt} + \beta_{31} X_{1t} + \beta_{32} X_{2t} + \ldots\ldots\ldots + \beta_{3K} X_{Kt} + \delta_{3t}.$$
$$Z_{Mt} = \alpha_{M1} Z_{1t} + \alpha_{M2} Z_{2t} + \ldots\ldots\ldots + \alpha_{M,M-1} Z_{M-1,t} + \beta_{M1} X_{1t} + \beta_{M2} X_{2t} + \ldots\ldots + \beta_{MK} X_{Kt} + \delta_{Mt}$$

Where:

Y1, Y2 …. ,YM = a number of endogenous variables M, X1, X2 ......,XM = a number of exogeneous variables M $\mu 1$, $\mu 2$ ...., μM= a number of residuals M, t = observation, β = endogenous variable coefficients γ = exogeneous variable coefficients.

IV. RESULTS AND DISCUSSION

The results of the estimation of the simultaneous comparison model as a whole are shown in Tables 4.1 and 4.2. When discussing the results of the estimate of total regional expenditure, it appears that all comparisons have a high level of explanation. This can be seen from the assay coefficient (R2), which each reach 0.814 and 0.959 and 0.59, meaning that each of the exogenous variables used in the model can have 81 percent, 96 percent and 59 percent diversity of endogenous variables to declare. Judging from the value of the F test statistic, all equations have a Pr> F value of 0.0000, along with the exogenous variables used, they have a significant effect on the endogenous variables.

Table 4.1 Local Government Spending Model

Variable	Total Local Government Spending (Lntlgs)		Variable	Direct Spending (Lnds)	
	Coeficient	*P-Value*		Coeficient	*P-Value*
Constanta	1.438	0.000***	*Constanta*	46.568	0.000***
Lnds	0.326	0.000***	Lndsas	0.0910	0.034**
Lnis	0.616	0.000***	Lndsinds	0.0577	0.247
$R^2 = 0.814$	Prob >F=0.000		Lndsss	0.0791	0.000***
			lndsinfs	0.1901	0.000***
			lndsehs	0.3045	0.000***
			$R^2 = 0.59$	Prob >F=0.000	
Variable	Indirect Spending (Lnis)				
	Coeficient	*P-Value*			
Constanta	11.330	0.191			
Lngrdp	-0.022	0.000***			
Lna	0.054	0.226			
Lntpop	-0.034	0.001***			
Inlgr	0.094	0.001***			
Lnpsf	0.060	0.000***			
Lngaf	0.796	0.000***			
Lnis t-1	3.05E-07	0.000***			
$R^2 = 0.959$	Prob >F=0.000				

Source: data prosessed, (2019)

The findings of the results of the simultaneous comparison test on the regional expenditure model show that the structure of district and municipal expenditure in East Java is dominated by indirect expenditure, which is relatively much larger than direct expenditure, which means that regional governments are a priority indicate indirect expenditure. Where the findings of the model for total regional expenditure show that direct expenditure has a significant and positive effect on total regional expenditure with a parameter of 0.326, meaning that total regional expenditure is affected by direct expenditure by 32.6 percent, if direct expenditure is increased by 100 percent, total regional expenditure will increase by 32.6 percent or if direct expenditure is increased by 1 billion rupiah, then total regional expenditure increases by 326 million rupiah a year. Meanwhile, with indirect expenditure that has a real and positive impact on total regional expenditure with a parameter 0.616, that total regional expenditure is affected by indirect expenditure by 61.6 percent or if indirect expenditure is increased by 1 billion rupiah, the total regional spending increases from 616 million rupiah per year, which means that the regional income and spending budget in East Java districts and cities is still dominated by indirect expenditure.

In addition, the estimates are the result of the comparison of the indirect expenditure of the regional government, that the indirect expenditure is positively and significantly influenced by local income variables, revenue sharing resources and general allocation funds, but the GRDP/economic growth and the population have a negative and significant effect, while the area of influence is positive, but not statistically significant, except that indirect expenditure is also significantly and positively influenced by the delay in indirect expenditure. This fact shows that regional indirect expenditure has responded more to the increase in general allocation funds and Revenue Distribution Funds and increased locally generated revenue. The marginal effect of an increase in general allocation fund general allocation fund on regional indirect expenditure is greatest, followed by locally generated revenue and Revenue Distribution Funds. This is in line with the opinion of (Barro, 1990).

Referring to the results of the simultaneous regression test on the indirect store model, the PDRB parameter estimator obtained by -0.022 means that the GRDP has a negative relationship with indirect expenditure, demonstrating that a GRDP increase of 1 billion has the potential to affect regional reduce indirect expenditure by 22 million rupiah a year. For the population, the estimated parameter obtained with 0.034 and has a negative relationship, this shows that an increase in the population of an area by 100 percent has the potential to reduce indirect expenditure by 3.4 percent per year. An area's response to a change in the amount of regional indirect expenditure is insignificant, meaning that a change in the area does not respond to an area's indirect expenditure. The local income parameter estimate results of 0.094, which means that locally generated revenue has a positive and real relationship, if an increase in local income by 1 billion rupiah will increase indirect expenditure by 94 million rupiah per year. The Estimated Profit Sharing Fund parameter, obtained at 0.060, means that the Regional Revenue Sharing Fund has a significantly positive relationship with Indirect Expenses and as the Revenue Sharing

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Fund. 1 billion is increased, indirect expenditure will increase by 60 million rupiah increase annually. Although the General Allocation Fund has obtained parameters with the highest return of 0.796, this means that the general allocation fund has a significantly positive relationship with indirect expenditure, if the general allocation fund is increased by 1 billion rupiah, indirect expenditure will increase by 796 million rupiah per year. Local governments respond to general allocation fund to incur more indirect expenditure than by exploring the sources of local income.

While the estimation results of the direct expenditure model are obtained, direct expenditure is positively and significantly influenced by direct expenditure in the agricultural sector, industrial sector, services sector and direct expenditure in the education and health sector. The estimate results show parameters of direct expenditure in the agricultural sector, achieved a result of 0.124, which means that direct expenditure in the agricultural sector has a positive relationship with direct expenditure in the region.If direct expenditure in the agricultural sector with 1 billion rupiah regional direct expenditure will increase by 124 million rupiah per year. The estimated parameter of direct expenditure of the industrial sector by 0.131 means that the direct expenditure of the industrial sector is positively related to regional direct expenditure, if the direct expenditure of the industrial sector is increased by 1 billion rupiah, the regional direct expenditure increases by 131 million rupiah per year. While the estimated results of the parameter direct expenditure on the services sector were 0.138, which means that if direct expenditure on the services sector were increased by 1 billion rupiah, regional direct expenditure would increase by 138 million rupiah per year. Estimated parameter outcomes for direct expenditure in the education and health sector were 0.437, which means that if direct expenditure in the education and health sector is increased by 1 billion rupiah, regional direct expenditure will increase by 437 million rupiah per year. Based on the description of the results of the above analysis, demonstrate that regional expenditure is influenced by the factors that constitute indirect and direct expenditure. The factors influencing regional revenues and expenditures in districts / cities in East Java are relatively similar.

Although the estimate results of the economic growth model show that all comparisons have a high exogenous level. This can be seen from the assay coefficient (R2) reaching 0.814, which means that each of the exogenous variables used in the equation can explain 81 percent of the diversity of endogenous variables. Based on the statistical value of the F test, all comparisons have a Pr> F value of 0.0000, which means that together with the exogenous variables used, they have a significant effect on the endogenous variables. The estimated results of economic growth are shown in Table 4.2

Tabel 4.2 Economic Growth Model

Variable	Gross regional domestic product (lngrdp)	
	Coeficient	*P-Value*
Constanta	*-7.498*	*0.000*
lngrdpas	0.046	0.067*
lngrdpis	0.356	0.000***
Lngrdpss	0.344	0.003***
Lnds	0.307	0.012***
Lnis	0.359	0.044**
Lndsinf	0.038	0.521
Lndsas	0.017	0.076*
Lndsis	-0.056	0.203
Lndsss	-0.046	0.103
Lnbldikes	-0.179	0.024**
Lntpop	-0.038	0.597
lnun	0.006	0.934
lnumr	0.033	0.076*
R^2 = 0.814	Prob > F = 0.000	

Source: data prosessed, (2019)

Judging from the parameter values of each exogenous variable, it shows: for indirect expenditure of 0.359, this means that if there is an additional indirect expenditure of 100 percent, it can boost economic growth of 35.9 percent for the GRDP of the industrial sector with a parameter value of 0.356 If the GRDP of the industrial sector is increased by 100 percent, economic growth will increase by 35.6 percent, because the GRDP of the services sector with an estimated value of 0.344 means that if the GRDP of the services sector has 100 percent will be increased, economic growth will increase by 34.4 percent. While direct expenditures with an estimated value of 0.307 mean that if direct expenditures are added 100 percent, economic growth will grow by 30.7 percent, for the GRDP of the agricultural sector with a parameter of 0.046, meaning if the GRDP of the agricultural sector is increased by 100 percent, then growth the economy rises by 4.6 percent and the regional minimum wage has a parametric value of 0.033, which means that if the regional minimum wage is increased by 100 percent, the economic growth rate increases by 3.3 percent, while direct expenditure of the agricultural sector increases by parameter value of 0.017 the level mean economic growth will only increase by 1.7 percent with an increase in direct expenditure in the agricultural sector by 100 percent. While direct expenditure on education and health has an opposite / negative but significant marginal effect of 0.179, which means that if direct expenditure on education and health is increased by 100 percent, it will reduce economic growth by 17.9 percent.

As the results of the estimated parameters of the GRDP of the agricultural sector, GRDP of the industrial sector, GRDP of the services sector, direct expenditure, indirect expenditure, direct expenditure of the agricultural sector, direct expenditure of the education and health sector and regional minimum wages are positive and have a significant effect on economic growth. However, as regards infrastructure expenditure, expenditure on industrial services, population and unemployment has no significant impact on regional economic growth. While direct expenditure on industry, services, education and health care has a negative effect on economic growth. General economic growth is affected by regional spending, the GRDP of the industrial, service and agricultural sectors, and by regional minimum wages according to the recommendations of (Nugroho, 2017), (Khusaini, 2016), (Faisol, 2018), (Zulkarnain et al., 2020).

Referring to the estimate results of the economic growth equation on a number of exogenous variables, including those with large marginal effects, namely indirect and direct expenditure, the effectiveness of indirect expenditure differs little from direct expenditure, while direct expenditure compared to the budgetary allocation reflects the regional budget for income and expenditure are far smaller than indirect shopping. This is contrary to the concept of decentralization, where decentralization expects budget allocations to be more on track so that their effectiveness will be higher. The success of decentralization requires terms or conditions, including: (Todaro, 2000) all local authorities have a good answer to the tasks and responsibilities given in this regard regarding the use of the regional budget, and (2) all local authorities have good capacity in terms of human and financial resources to carry out their tasks and functions. It appears that these conditions are not yet met, so this has happened. This shows that regional spending is not well designed, which is a form of regional impunity (both from regional capacity and response) when accepting delegated responsibilities.

Economic growth is in fact defined as a process in which real GRDP or per capita real income increases continuously through an increase in productivity per capita (Salvatore, D. & Dowling, 1977). Economic growth is not the only measure of development success, it is not even the region's only development goal. But economic growth has a strategic value, because economic growth is a prerequisite for improving people's well-being, and economic growth is a prerequisite for achieving other development goals, such as: increasing people's income and wealth, equity or the provision of social and other benefits.

V. CONCLUSION

The structure of regional spending in districts and cities in East Java, Indonesia is dominated by indirect expenditure, which is relatively much larger than direct expenditure, which means that local authorities prioritize indirect expenditure. Regional expenditure consisting of direct and indirect expenditure has a significant positive effect on regional economic growth. Some exogenous variables with a large marginal effect are indirect and direct expenditure, but the effectiveness of indirect expenditure differs slightly from that of direct expenditure, while direct expenditure is much smaller than indirect expenditure compared to the budgetary allocation from the anggaran pendapatan dan belanja daerah. This is contrary to the concept of decentralization, where decentralization expects budget allocations to be more on track so that their effectiveness will be higher. This shows that regional spending is not well designed, which is a form of regional impunity (both from regional capacity and response) when accepting delegated responsibilities. Total regional expenditure is influenced by the factors that constitute indirect and direct expenditure. The factors influencing regional revenues and expenditures in districts / cities in East Java are relatively similar. Regional indirect expenditure and direct expenditure can stimulate economic growth. Overall economic growth is affected by regional spending, the GRDP of the industrial, services and agricultural sectors, as well as regional minimum wages in accordance with the recommendations of (Khusaini, 2016), (Faisol, Pudjihardjo M, 2020).

Regional indirect expenditure is more responsive to increasing general allocation fund, income distribution and locally generated revenue. The marginal effect of an increase in general allocation fund on regional indirect expenditure is greatest, followed by locally generated revenue and revenue distribution funds. This is in line with the opinion of (Mangoesoebroto, 2010).

Policy Recommendations

It is recommended that regional governments increase direct expenditure and reduce indirect expenditure, so that economic growth can increase significantly. In order to achieve economic growth optimally, the regional government must divide a balanced regional expenditure between direct expenditure and indirect expenditure.
The regional government must prepare itself for the authority and responsibility of the central government, so that it can shape regional expenditure in a good and targeted manner.

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