

Model Knowledge Fiscal Potential Impact on Economic Growth and Public Welfare of East Java, Indonesia

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Abstract

The knowledge objectives of this study to analyses the effect of Local Revenue, Public Allocation Funds, Profit Sharing Funds on Economic Growth, Public welfare in East Java 2009-2017. This study uses explanatory study with a quantitative approach. Data collection techniques in this study employed by means of literature study. Data analysis technique use Structural Equation Model (SEM) with the Smart Partial Least Square (PLS) tool. The findings of this study show that: (1) Local Revenue has a significant effect on Economic Growth in East Java; (2) Local Revenue has a significant effect on the Public welfare in East Java; (3) Public Allocation Funds have no significant effect on Economic Growth in East Java; (4) Public Allocation Funds have a significant effect on Public welfare in East Java; (5) Profit Sharing Funds have a significant effect on Economic Growth in East Java; (6) Profit Sharing Funds have a significant effect on Public welfare in East Java; (7) Economic Growth has a significant effect on Public welfare in East Java.

Keywords

Local Revenue, Public Allocation Funds, Profit Sharing Funds, Economic Growth, Public Welfare

1. Introduction

Regional development as an integral part of national development indivisible from the principle of local autonomy. In implementing local autonomy there is a shift of authority and accountability in allocating resources from the central government to the local government. Local autonomy offers a large portion of authority to local governments to be able to manage their local finances. Law Number 22 of 1999 concerning Local Government stipulate that development of autonomy in the regencies and cities is run by observing the principles of democracy, community participation, equity and justice and taking into account the potential and diversity of the regions. One aspect of local government that must be regulated thoroughly is the issues of local financial management and local income and expenditure budgets [12].

Local financial management will have an impact on the economic fate of a region, because regions can progress and prosper or vice versa, becoming poor and not prosperous will depend on how an area manages its finances. Local management that is run efficiently and effectively will encourage better economic growth which then leads

to increasing public welfare in an area. According to [3], public welfare is one of the final goals to realizing the effective and efficient governance in the framework of creating fiscal decentralization. Development planning is seen as a guideline or role model in order to produce development in a positive direction or in other words can be used as a bridge in the economy if the government expects better success [8]. Therefore, a meticulous planning in a development effort becomes critical element for improving better public welfare.

An economy that grows and develops inseparable from the government role through efforts planned and implemented with the target of public welfare. [8] states that economic growth in an area can be triggered by realization of fiscal decentralization. According to Bodman et al. (2009), an increase or decrease in economic growth level is the impact of the transfer of responsibilities from the central government to the local government as a form of the creation of fiscal decentralization. According to Law No. 33 of 2004 the revenue sources used for local government funding in implementing fiscal decentralization includes Local Revenues (PAD), Public Allocation Funds (DAU), Special Allocation Funds (DAK), Profit Sharing Funds (DBH), and other revenues that legitimate. Through income, the local government must be able to increase its opinion to finance development activities, especially in the economic field. Economic growth is a continuous process/change and a country's efforts to enlarge or to increase the income of its people. The economic growth of a region will increase due to fiscal potential and regional financial ratios. Fiscal potential consists of components according to the Minister of Finance No. 224 / PMK.07 / 2008, among others: Local Revenues, Public Allocation funds, Profit Sharing and other legitimate regional revenues. Fiscal potential can be used to encourage and enhance economic growth which further enhances public welfare [10].

Economic growth is reflected in efforts made by local governments in boosting high Local Revenue and being able to manage it well so that it can be perceived the role of local autonomy in empowering the potential of the region has gone well. Local Revenue represents all local revenues in the form of assets maximalization or debt lowering from various sources within the period of the relevant fiscal year. The sum or number of PAD received by an area should not be a measure of the economic activity movement, but measured by the extent to which the PAD regulates economic activity in the region, so that it can have a positive impact on people's welfare [16]. The end results of the work by [22] show that PAD has a significant effect on economic growth. This indicates that if PAD increases, the funds owned by the regions to explore and develop their potential will also expand, so as to increase economic growth.

Likewise, a high Public Allocation Fund will be able to develop its potential which will increase as well, so as to increase economic growth, such as [5] states that through Public Allocation funds income, allocation of less productive routine expenditure should be lower than capital expenditure. Local governments should pay attention to this matter so that capital expenditures lead to infrastructure improvements can support economic growth. [22] also found that DAU had a significant effect on economic growth.

Then Profit Sharing Funds (DBH) are funds sourced from State Budget Revenues allocated to regions by taking into account the potential of producing regions based on certain percentage figures to fund regional needs in the implementing decentralization context. [7] states that Profit Sharing funds are funds targeted at funding all local needs in decentralization implementation, which is obtained from percentage allocation of the State Budget Revenues. Profit Sharing Fund of government-derived consists of two types, namely tax and non-tax. DBH is the main capital derived from balancing funds in addition to DAU and DAK and is not part of the PAD. DBH is a potential capital for the region to finance local development and expenditure. The results of research conducted by [10] found that Profit Sharing had a positive effect on economic growth as well as public welfare.

2. Literature

According to Law Number 33 of 2004 regarding Financial Balance between Central and Regional Article 1 point 18 that Local Revenue, hereinafter referred to as PAD, is income derived from regions levied based on local regulations in accordance with rules and regulations. Then [8] defines PAD as all local revenues come from local economic sources. Local Revenue is divided into four types of income, namely local taxes, local retributions, local-owned companies and the separated results of wealth management of the region, other legitimate Local Revenue.

Definition of Local Revenue proposed by [12] is income taken from local tax payments, local retribution resulting from local property, results of the management of separated local assets and other legitimate local revenue. As stated that local revenue is a local revenue come from various local economic sources, it is hoped that each local government can develop good economic infrastructure in their respective regions in order to upsurge their income. Local Revenue is income obtained by regions collected based on local regulations in accordance with the legislation. Local Revenue as a source of local revenue needs to be continuously increased so that it can bear some of the expenditure needed for the administration of government and development activities which increase every year so that the independence of broad, real and responsible regional autonomy can be implemented [2].

Public Allocation Fund

Based on Law Number 33 of 2004, Public Allocation Funds are funds sourced from State Budget Revenues allocated for the purpose of equal distribution of financial capacity between regions, to fund regional needs in the

context of implementing decentralization. Public Allocation Fund utilization is determined entirely by the local itself. Included under definition of equal distribution of local financial capabilities is a guarantee of the continuity of the local governments administration in all regions in the framework of offering basic services to the public, and is a unity with the general revenue of the Local Revenue and Expenditure Budget.

In line with Law No. 33 of 2004, [15] stated that the Public Allocation Fund (DAU) is a fund sourced from State Budget revenues allocated with the target of equalizing inter-regional financial capabilities to fund local needs in the context of implementing decentralization. According to Sidik in Kuncoro (2014), the Public Allocation Fund purpose to equalize inter-regional financial capacity which is intended to reduce inequality in financial capacity between regions through application of formulas that take into account the needs and potential of the region.

According to [15] the Public Allocation Fund targets to equalize financial capabilities between regions which are intended to reduce inequality of financial capacity among regions through the application of formulas that take into account regional needs and potential. Regional DAU is determined by the size of the fiscal gap of a region, which is the difference among local needs (fiscal need) and local potential (fiscal capacity).

Economic growth

In actual economic activity, economic growth can be interpreted as a fiscal economic development that occurs in a country such as: (1) increase in number and production of industrial goods; (2) infrastructure development; and (3) the increase in production results from economic activities that take place within a certain period, for example one year [4]. According to [19] Economic growth is a quantitative measure describes development of an economy in a given year when compared to the previous year. An economy is said to grow if there is an increase in output per capita in the long run, economic growth as a quantitative measure that describes the development of an economy in a given year when compared to the previous year [19].

Public welfare

Welfare has many dimensions, which can be seen from the material dimensions and non-material dimensions. In terms of material can be measured by income and consumption approach. [13] state that conceptually and economically consumption data is more appropriate to measure welfare compared to income data because consumption data is a more direct measure of welfare.

To improve the public welfare, development also seeks to foster the aspirations and demands of society to realize a better life. Development can not only be seen from the aspect of growth. One result of development that only applies the growth paradigm is the emergence of a gap between the rich and the poor, and rampant unemployment. Growth is always associated with an increase in national income (gross national products).

Conceptual Framework

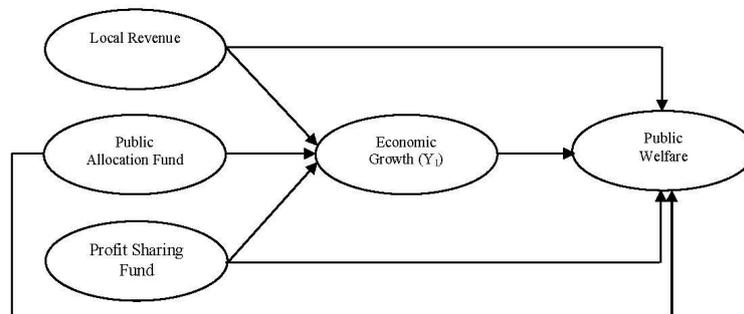


Figure 1. Conceptual Framework

3. Research Methods

This research includes explanatory study. Explanatory study is employed with the objective to analyse correlation among variables through hypothesis testing [17]. The approach used is quantitative methods. According to [18] quantitative method is a method that uses a number of samples and numerical data or in the form of numbers.

Definition of variable operational is a definition given to a particular variable because it has different meanings and connotations in different cultures [14]. The following will describe operational definitions of each research variable as follows:

Local Revenue is all regional revenues deriving from local economic sources. Local Revenue Variables in this study use data on local taxes, regional retribution and other PAD of East Java in 2009 -2017.

Public Allocation Funds are funds derived from the State Budget Revenue that are allocated with the target for equal distribution of financial capacity among regions to finance their expenditure needs in the context of implementing decentralization. The Public Allocation Fund in this study uses Public Allocation data of East Java for 2009-2017.

Profit Sharing Funds are funds sourced from taxes and natural resources, Land and Building Taxes (PBB), Fees for Acquisition of Land and Building Rights and Income Taxes. Profit Sharing Fund variables in this study use tax Profit Sharing data non-tax results of East Java in 2009-2017.

Economic growth is the development of activities in the economy that causes goods and services produced in society to increase and people's prosperity increases. Economic growth in this study was seen through the rate of GRDP in East Java in 2009-2017.

Public welfare is a condition of complete basic needs which is reflected in a decent house, adequate clothing and food needs, cheap and quality education and health costs or conditions where each individual is able to maximize his utility at a certain budget level and conditions where physical and spiritual needs are met. Indicators of public welfare variables refer to [19], namely: per capita income, life expectancy and average length of schooling in East Java in 2009-2017.

Analysis technique selected to analyze the data and test the hypothesis in this study is The Structural Equation Model (SEM). To answer the hypothesis, Partial Least Square (PLS) is executed. According to [6] calculations were carried out using Smart Partial Least Square (PLS) tools, due to the multi-lane shape and model used in the form of Reflective. The calculation model is done using Smart PLS tools because in this study has a multi-path correlation and formative and reflective.

4. Analysis and Discussion

Inner Model Evaluation

Inner model which is sometimes also called (inner relation, structural model and substantive theory) specifies the effect among research variables (structural model).

Inner Model Test or Structural Model Test

The results of the conformity analysis of the structural model-built show that the overall model has been "relevant" to explain variables studied and their effects on each variable. Calculation of the value of Q^2 gets a value of 0.977 or has exceeded the critical limit of 0.5, so the structural model has been declared fit and appropriate.

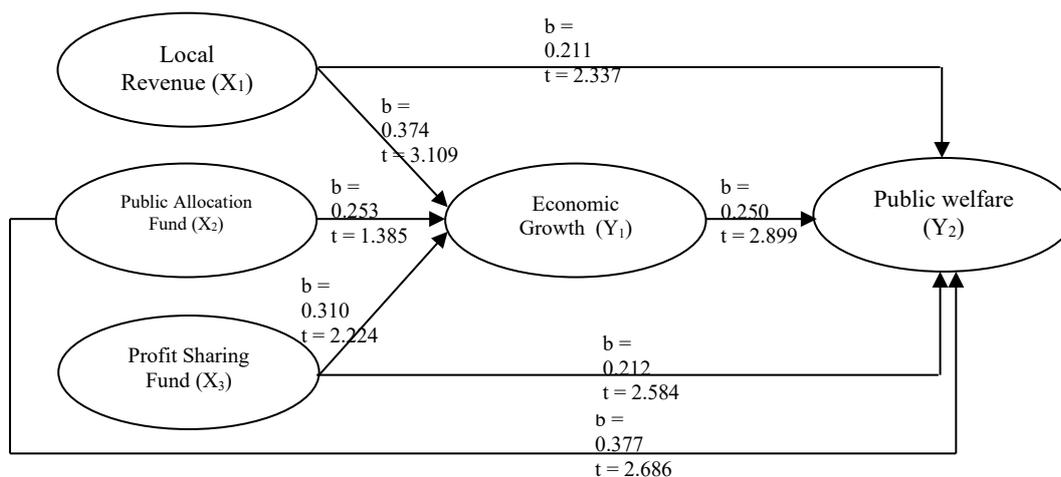


Figure 2. PLS Inner Model

There are exogenous variables in the inner model studied, namely Local Revenue, Public Allocation Funds, and Profit-Sharing Funds, while endogenous variables in the inner model studied are Economic Growth and Public welfare. The results of the inner weight value in Figure 1 above indicate that the variable Economic Growth is affected by Local Revenue, Public Allocation Funds, and Profit-Sharing Funds, while the Public welfare variable is affected by Economic Growth, Local Revenue, Public Allocation Funds, and Profit-Sharing Funds shown in the following equation:

$$Y_2 = 0.211 X_1 + 0.377 X_2 + 0.212 X_3 + 0.250 Y_1$$

$$Y_1 = 0.374 X_1 + 0.253 X_2 + 0.310 X_3$$

For variables of Local Revenue, Public Allocation Funds, and Profit-Sharing Funds that affect the Economic Growth variable has a R^2 value of 0.721 which indicates a "good" model. Then, for the variables of Economic Growth, Local Revenue, Public Allocation Funds, and Profit-Sharing Funds that affect the Public welfare variable has a R^2 value of 0.917 indicating a "good" model.

After the process of identifying of the model, than the next step is the estimation [23].

5. Result And Discussion

Data analysis result shows that the Local Revenue had a significant effect on Economic Growth in East Java which was evident from the t value of 3.109 which means greater than 1.96, so that it can be explained that an increase in economic growth in East Java can be formed through the existence of local revenue tall one. The effect of local financial performance on public welfare is positive, which shows that the increasing local revenue will increase economic growth in East Java. Thus the first hypothesis in this study which reads "Local Revenue has a significant effect on Economic Growth", can be declared acceptable.

The results of the data analysis showed that the Local Revenue had a significant effect on the Public welfare in East Java which was evident from the t value of 2,337 which means greater than 1.96, so that it can be explained that the welfare of the people in East Java can be formed through high local revenue . The effect of local revenue on people's welfare is positive which shows that the higher the original regional income, it will be able to improve the welfare of the people in East Java. Thus the second hypothesis in this study which reads "Local Revenue has a significant effect on Public Welfare", can be declared acceptable.

The findings in this study prove that local income plays an important role in improving public welfare. In other words, the public in East Java can be formed through high local revenue. Therefore, if the East Java Government wants to improve the welfare of the community, it is necessary to pay attention to the level of local revenue. This result is not in line with the findings of research conducted by [22] which prove that Blood Original Income has no significant effect on the welfare of society and has a negative direction.

The results of the data analysis showed that the Public Allocation Fund did not have a significant effect on Economic Growth in East Java as evidenced by the t value of 1,385 which means smaller than 1.96, so it can be explained that economic growth in East Java may not be increased through allocation funds adequate general. The effect of Public Allocation funds on economic growth is positive. Thus the third hypothesis in this study which reads "Public Allocation Funds have a significant effect on Economic Growth", can be declared not accepted.

This result is in line with the findings of [22] which prove that DAU has no significant effect on economic growth. However, this result is not in line with the findings of research conducted by [20] which prove that the Public Allocation Fund has a positive and significant effect on economic growth.

The results of the data analysis showed that the Public Allocation Fund had a significant effect on Public welfare in East Java which was evident from the t value of 2,686 which means greater than 1.96, so that it can be explained that the welfare of the people in East Java can be established through adequate Public Allocation funds . The effect of the Public Allocation fund on public welfare is positive which indicates that the higher the Public Allocation fund that is budgeted, it will improve the welfare of the people in East Java. Thus the fourth hypothesis in this study which reads "Public Allocation Funds have a significant effect on Public Welfare", can be declared acceptable.

The findings in this study prove that Public Allocation funds have an important role in improving public welfare. In other words, public welfare in East Java can be created through high Public Allocation funds. Therefore, if the East Java Government wants to improve the welfare of the community it is necessary to pay attention to the level of Public Allocation funds. This result is not in line with the findings of research conducted by [22] who found that the Public Allocation Fund did not have a significant effect on people's welfare.

6. Conclusion

Local Revenue has a significant effect on Economic Growth and Public welfare in East Java, Public Allocation Fund has no significant effect on Economic Growth but have a significant effect on Public welfare in East Java, Profit Sharing Funds have a significant effect on Economic Growth and Public welfare in East Java, and Economic growth has a significant effect on Public welfare in East Java.

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