

## EFFECT OF FISCAL DECENTRALIZATION ON CAPITAL EXPENDITURE, GROWTH, AND WELFARE

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### Abstract

This research analyzes the influence of fiscal decentralization on capital expenditure, economic growth, and social welfare of 29 regencies and 6 cities in Central Java Province based on the data of year 2004 to 2008. The method used to analyze the hypotheses is the Partial Least Square. The results shows that fiscal decentralization has no significant effect on capital expenditure; fiscal decentralization has significant effect on economic growth and social welfare; capital expenditure has no significant effect on economic growth and social welfare; and economic growth has significant effect on social welfare.

**Keywords:** Fiscal decentralization, capital expenditure, economic growth, social welfare

**JEL classification:** H76, I31, 043

### Abstrak

Penelitian ini menganalisis pengaruh desentralisasi fiskal terhadap belanja modal, pertumbuhan ekonomi, and kesejahteraan masyarakat di 29 kabupaten and 6 kota di Provinsi Jawa Tengah berdasarkan data tahun 2004 sampai dengan 2008. Metode yang digunakan untuk menganalisis hipotesis penelitian adalah *Partial Least Square* (PLS) dengan alpha 5%. Hasil penelitian menunjukkan bahwa desentralisasi fiskal berpengaruh tidak signifikan terhadap belanja modal, desentralisasi fiskal berpengaruh signifikan terhadap pertumbuhan ekonomi and kesejahteraan masyarakat, belanja modal berpengaruh tidak signifikan terhadap pertumbuhan ekonomi and kesejahteraan masyarakat, and pertumbuhan ekonomi berpengaruh signifikan terhadap kesejahteraan masyarakat.

**Kata Kunci:** Desentralisasi fiskal, belanja modal, pertumbuhan ekonomi, kesejahteraan masyarakat

**JEL classification:** H76, I31, 043

### INTRODUCTION

Regional autonomy is conducted by giving authority which is broad, real, and responsible to regions proportionally that is created by controlling, dividing, and using of national resources which is fair, also the balance of region and central finance. Besides, the implementation of regional autonomy is also conducted by principles of democracy, society participations, even-distribution, and justice, also observing the potency and variety of region. Province is an autonomous region and administrative area, it is functioned as a doer of authority

in central government which is delegated to governor (Mahi, 2005a). Real autonomous authority is freedom of region to implement regional authority on specific fields which obviously exist and needed also it grows, lives, and develops in region. In order to implement that regional autonomy, the region is given authority to excavate its own regional finance resources which is supported by the balance of finance between central and regional government, also between province and city as requirements in regional government system through fiscal decentralization (Kusumadewi, 2007)

Fiscal decentralization aims to make social welfare. That is why, if the regional government wants to increase the wealth of society, the regional government must increase the budget of Direct Expenditure including Capital Expenditure. In order to increase the budget of Direct Expenditure that consists of components of Capital Expenditure, the regional government must be able to increase Regional Income through the raise of PAD and Profit Dividing of Tax and Non-Tax (Mursinto, 2005a).

Indirect Expenditure is a component in Regional Expense which is occurred exactly because of routine activity funding mainly for region apparatus on related region, such as to pay wages of civil servants and honorary workers as compensation for civil servants because of the routine activities that are conducted in regions that will become income factor and will be used consuming activity to buy goods and services that are needed by the civil servants (Khasanah, 2007). Capital Expenditure as part of Direct Expenditure on Regional Income will be allocated by regional government to fund the building activities that is destined to society importance, such as; road facilities, bridges, telecommunication, electricity, schools, hospitals, markets, and the other public facilities that will be used by the society. Those kinds of public facilities will ease the society accessibility in doing economic activities. Besides, the society can also use the facilities to non-economic activities, especially in doing social activities on some available public fields that will impact to the wealth of the society itself. The new form of Regional Income Budget and Expenditure (APBD) aims to remove from routine differential/building to more orientated approach on programs (Suhab, 2004).

Two activities, which are civil servant consumption and regional government expenditure, will make demand of goods and services that will be responded by pro-

ducers to result goods and services that match with the necessity of civil servants and regional government. This economic activity will shape the value of Gross Regional Domestic Product (GRDP) and its change that is called economic growth. Economic growth as relative value of GRDP changing from time to time shows the process of income rising in society from time to time too. Income rise in society is shown by the increasing of income allocation to consumption of primary, secondary, and tertiary necessity so that the regional societies become wealthier, healthier, more educated, and reducing of criminality. That is why, economic growth will affect the wealth of society (Kusreni, 2009).

That condition in fiscal decentralization implementation has not matched as expected yet, because of some factors. According to Sriningsih (2009), to make fiscal decentralization be able to increase social welfare, it needs *revenue* and *expenditure* among the governments to raise the wealth of society. By doing so, fiscal decentralization will increase the wealth of society. The realization of decentralization fiscal will affect to the rise of capital expenditure, economic growth, and social welfare if the sum of income value taken by the region is relatively huge, so if the income value accepted by the region is relatively small, it will become obstruction to the objective of fiscal decentralization to increase capital expenditure, economic growth, and social welfare (Solihin, 2010). Also, with the allocation of capital expenditure on APBD that is relatively small (because of the high proportion of workers' expenditure on APBD), it becomes obstacle to regency/city to increase economic growth and social welfare. That is why, capital expenditure becomes unproductive. The indicator of the wealth of society nowadays is Human Development Index (HDI) which is counted from life expectation index, education index, and revenue index that is completed by regional crime index (RCI) that is

counted from crime rate per 1.000 citizens in every regency/city, it shows the successful indicator of development in increasing the wealth of society in regency/city. If the aim of development has succeeded, the rate of HDI will increase and the rate of RCI will fall.

Based on explanation about implementation of regional autonomy in Indonesia, with affected variable which is capital expenditure, economic growth, and social welfare, it indicates the existence of difference between theory and concept about regional autonomy. It makes the researcher interested to conduct research about the effect fiscal decentralization to capital expenditure, economic growth, and social welfare of regencies/cities in Central Java Province. The objective of research is to test and analyze the impact of fiscal decentralization to capital expenditure, economic growth, and social welfare of regencies/cities in Central Java Province; to test and analyze the effect of capital expenditure on APBD regency/city to economic growth and social welfare of regencies/cities in Central Java; and to test and analyze the effect of economic growth of regencies/cities to social welfare of regencies/cities in Central Java Province.

Public finance as part of economic science learns the process of decision maker by government, because every decision has effect to economy also household and private finance. Thus, it is important to develop economic models that help explaining the allocation of efficient/optimal resources, the meaning of justice, and anticipation because of financial or economy toward a public decision. So, focus of public finance is to learn revenue and government expenditure and to analyze implication from revenue and expenditure activities on allocation of resources, income distribution, and economic stability (Mahi, 2005b). Public finance is close related in the process of decision making based on principles of democracy. If the voters of

citizen representatives (in government) monitor the activities of their representatives, so the representatives will work harder and try to convince the voters that their contributions toward tax payments will affect better conditional achievement (Mursinto, 2005b).

In conducting fiscal decentralization, the principle of money should follow function is the principle that has to be watched or done, it means that every transfer or allowance of governing authority carries consequences toward budget that is needed to run that authority. Policy of central and regional finance balance is a derivative from the policy of regional autonomy as allowance of some governing authorities from centre to region. The bigger the authorities given, the higher cost needed by the region. That is why, in processing of decentralization, the principle of efficiency becomes a certainty that must be done. The budget to commit government tasks or public services has to be managed efficiently, but produce maximum output (Abdulla, 2007). Fiscal decentralization in Indonesia is fiscal decentralization of expense side which is funded mainly through transferring to region. By this fiscal decentralization design, autonomy essence of regional fiscal management is pointed at discretion (freedom) to expend fund appropriately with necessity and priority for each region. Most of the country's income remains to be kept by the central government in order to keep the unity of nation and state in the frame of Indonesia Republic (Saragih, 2003:40).

According to the Rules of Domestic Minister No.37 year 2010 about Orientation of Revenue Budget Composition and Regional Expenditure year 2011, classification of Regional Expenditure in APBD consists of routine expenditure (official expenditure) and development expenditure (public expenditure). Routine expenditure is used to fund the governing implementation everyday, such as official workers ex-

penditure, operational and maintenance expenditure, also official trip expenditure. Development expenditure is used to fund public services, such as infrastructures and public facilities. Development expenditure always becomes the main attention in government expenditure analysis, it is because of its characteristics that are directly focused on the quality of public services. The allocation strategy of development expenditure by the regional government is really determined by importance and regional necessity (Handoyo, 2010).

Capital expenditure is the expense that its benefit leans on more than one year of budget and will add assets or regional wealth, and then it will add routine budget toward operational cost and its maintenance (Susanti, 2008). Capital expenditure consists of public expenditure and official expenditure. Public expenditure is expenditure that the benefits can be enjoyed directly by the society. Public expenditure is capital expenditure that forms in physical investment (infrastructure development) that has economic value more than one year and affect to the addition of regional assets. Official expenditure is expenditure the benefits can be enjoyed directly by the officials not the society. Official expenditure causes the addition of constant assets and other inconstant assets. Official expenditure is estimated will give benefits in future period (Badrudin, 2010).

According to Arsyad (2004:45), Smith explained two main aspects economic growth which are total output growth and population growth. The main elements in total output growth are available natural resources (soil production factor), human resources (amount of citizens), and the stock existence of capital goods. Available natural resources are the basic container of production activities in society. The amount of available natural resources is the maximum limit for economic growth. Human resources (amount of citizens) have passive roles in the process of

output growth. Capital stock is production element which actively determines output level. The roles are very central in the process of output growth. The amount and level of output growth are based on the speed of capital stock growth until "maximum limit" of natural resources.

United Nations Development Program (UNDP) in 1990, introduced Human Development Index (HDI) which is arranged from three components; life duration (life expectation rate), educational level (combination between the number of literate citizens at 15 years above with their average duration of study), and the level of worthy life which is estimated by expense per capita that has been matched (*purchasing power parity*). Thus, the concept of wealthy society by combining health and education aspects together with food, clothing, and housing aspects become a unity with income level that has combined between approach of life quantity and quality. Wealthy society in not only measured based on physical calculation, but also non-physical factors such as; education, health, housing, work rate, family program and fertility, economy (especially the level of consumption per capita), crime rate, tourism trip, and access to mass media (Arsyad, 2004:38). In this study, to measure the wealth of society, it does not only use HDI but also the other social wealth indicator (non monetary) that is shown as crime rate. In order to make homogeneous indicator of crime rate among regions, it is needed to arrange Regional Crime Index (RCI) as ratio among the numbers of crimes per 1.000 citizens. Divider per 1.000 citizens is used to equal the indicator of crime rate among regions by considering the amount of citizens in regencies/cities in Central Java Province (BPS:2009).

Oates (1993), explained about *fiscal decentralization and economic development* that was conducted in 58 countries with the results that fiscal centralization negatively and significantly connected to

the level of income per capita. Oates also explained the same thing about *Fiscal Decentralization and Economic Development* that was conducted in 43 countries in 1985. Based on the samples of 18 industrial countries as objects of study, it was obtained that the result was the contribution of central government in public expense budget: 65% and from the samples of 25 industrial countries as objects of study, it was obtained that the result was the contribution of central government in public expense budget, average of more than 90%.

Ismail, *et al* (2004) researched about *fiscal decentralization and economic growth: evidence from selected muslim countries*. Ismail's study, *et al* (2004) tested the effect of fiscal decentralization toward economic growth in some Muslim countries. By using econometric analysis based on panel data in 4 selected Muslim countries as samples, the result was acceptance decentralization was bigger than expense decentralization and the indicator acceptance-production affected economic growth. The result of study also showed that fiscal decentralization had roles in those countries, especially in economic openness that also affected to economic growth.

Adi (2005) conducted study about the impact of fiscal decentralization toward economic growth based on case studies in regencies and cities of Java-Bali. The result showed that the implementation of fiscal decentralization was proved to increased regional economic growth and the region became more sensitive to necessity and local economic power. But, this result showed that not the whole regions really prepared to enter fiscal decentralization.

Suryanto *et al* (2005) researched about the effects of fiscal decentralization toward social welfare based on theoretical explanation and budget application. According to Suryanto *et al*, the approach that was used in this study is policy approaching that was based on previous output and or general picture that was experienced in

scope of study. The picture toward fiscal decentralization condition and social welfare was explained descriptively. The result of study Suryanto *et al*, showed that fiscal decentralization had not been beneficial for the rise of social welfare because of asymmetry between planning with society necessity in regions.

Vazques researched about *fiscal decentralization and economic growth: a comparative study of china and india* (2006). The results showed that the model of fiscal decentralization that was applied in China and India was implemented simple and step by step not like the other countries which implemented fiscal decentralization that was *bing-bang* and complicated.

Suhendra (2006) explained that fiscal decentralization during the first 5 years from 1<sup>st</sup> January 2001 was still weak but in a condition of being ideal. Some things that became Suhendra's output issue were the power and roles of taxation in local level of regencies/cities still weak because the government of regency/city was still depended on central government; formula deciding in Public Allocation Fund (DAU) was connected with political interest.

Akai *et al* (2007) researched about *fiscal decentralization and economic volatility: evidence from state-level cross-section data of the United States*. This study explained the theory that was: fiscal decentralization would reduce the variant of GDP growth. The result of study Akai *et al* (2007) showed that there was a significant negative relationship between fiscal decentralization and economic volatility. That is why, if fiscal decentralization increased, economic volatility happened.

Nasution conducted study about roles and competency of government ability toward economic growth and social welfare in Batam (2007). The conclusion of Nasution's study was governing ability of Batam affected significantly toward the level of social welfare and governing abil-

ity of Batam affected significantly toward the level of economic growth.

Widhiyanto conducted study about *fiscal decentralization and indonesia regional income disparity* based on the data in 1994 until 2004 (2008). The result showed that fiscal decentralization in Indonesia could affected not only the speed of economic growth but also reduced the imbalance of regional income per capita (GRDP per capita).

Wibowo researched about the *effect of fiscal decentralization toward regional economic growth* (2008). The conclusion of the study was fiscal decentralization in Indonesi generally gave positive impacts toward regional development during 1999-2004.

Sasana researched about *roles of fiscal decentralization toward economic work in regencies/cities of Central Java* (2009). The study was conducted with whole population of Regencies/Cities in Central Java from 2001 until 2005 by lane analysis. The result of the study was fiscal decentralization affected significantly and had positive relationship toward the speed of economic growth in regencies/cities in Central Java and economic growth affected significantly and had positive relationship toward the wealth of society in regencies/cities in Central Java.

Priyarsono *et al* researched about fiscal decentralization, tax effort, and economic growth: empirical study of regencies/cities in Indonesia 2001-2008 (2010). The result of study was allocation of routine expenditure still had bigger contribution than development budget, main funding resources of regional expenditure was still dominated by balance fund so regional autonomy had not been optimum yet, also PAD and balance fund gave positive influence toward the rise of regional economic growth.

Badrudin researched about the effects of capital expenditure and economic growth toward the wealth of society in re-

gencies/cities of Central Java Province (2011). The study was conducted using data from 2001 until 2008 with whole population of regencies/cities, using regression analysis model with *polled* The result of study was capital expenditure affected insignificantly toward the wealth of society in regencies/cities of Central Java and economic growth affected significantly toward the wealth of society in regencies/cities of Central Java Province.

Based on those explanations, the research hypothesis is arranged as follows:

- H1: fiscal decentralization had significant effect on capital expenditure of regency/city in Central Java Province;
- H2: fiscal decentralization had significant effect on economic growth of regency/city in Central Java Province;
- H3: fiscal decentralization had significant effect on social welfare of regency/city in Central Java Province;
- H4: capital expenditure had significant effect on economic growth of regency/city in Central Java Province;
- H5: capital expenditure had significant effect on social welfare of regency/city in Central Java Province; and
- H6: economic growth had significant effect on social welfare of regency/city in Central Java Province.

## METHODS

This study encloses the whole regencies/cities in Central Java Province (29 regencies and 6 cities) because Central Java Province until 2008 did not commit area blooming to region of regencies/cities in that province so it will be seen the originality or authentication of regencies/cities since regional autonomy was valid on 1<sup>st</sup> January 2001. Based on the amount of samples of 35 regencies/cities from 2004 until 2008, the data formed in *pooled the data*. The use of this data condition is conducted so that in using data analysis model of *Partial Least Square* fulfills the requirements to be operated. Research model

to inner model (equation 1-3) and outer model (equation 4-8) is:

$$\eta_1 = \gamma_1 \xi_1 + \zeta_1 \quad (1)$$

$$\eta_2 = \beta_1 \eta_1 + \gamma_2 \eta_1 + \zeta_2 \quad (2)$$

$$\eta_3 = \beta_2 \eta_2 + \beta_1 \eta_1 + \gamma_3 \xi_1 + \zeta_3 \quad (3)$$

$$x_1 = \lambda_{x1} \xi_1 + \delta_1 \quad (4)$$

$$\xi_1 = \lambda_{y1} \eta_1 + \varepsilon_1 \quad (5)$$

$$\xi_2 = \lambda_{y2} \eta_2 + \varepsilon_2 \quad (6)$$

$$y_{31} = \lambda_{y31} \eta_3 + \varepsilon_3 \quad (7)$$

$$y_{32} = \lambda_{y32} \eta_3 + \varepsilon_4 \quad (8)$$

where:

$\eta$  is endogen vector (dependent) of latent variable

$\xi$  is variable vector of latent exogen

$\zeta$  is variable vector of residuals (unexplained variance)

$\beta_{ji}$  and  $\gamma_{ib}$  is path coefisien which relate endogen predictor and latent variable of exogen

$\eta$  and  $\xi$  on range of index  $i$  and  $b$

$\zeta_j$  is inner variable residuals

$x$  and  $y$  is indicator or manifest variable for latent variable of exogen and endogen

$\varepsilon_x$  and  $\varepsilon_y$  is residuals which interpreted for measurement error

## RESULTS

The evaluation of *goodness of fit model* is conducted toward *outer model* which measured by using *convergent validity* to validity test showed that *outer loading* was in absolute number, which was *outer loading* HDI (0,903) and *outer loading* RCI (0,881) was bigger than 0,7. The value of *Average Variance Extracted* (AVE) toward

Fiscal Decentralization variable was 1, Capital Expenditure variable was 1, Economic Growth variable was 1, and Social Welfare variable was 0,7954 which was all bigger than 0,5. It means that the measurement model to test construction validity in order to know study instrument ability measured what it supposed to be measured by using *convergent validity* and *Average Variance Extracted* (AVE) is valid (Abdillah, 2009:61).

HDI and RCI validity as the indicator to measure social welfare variable is also showed by *outer weights* result on Table 1. It can be seen the value p-value toward HDI and RCI are 2,57014E-79 and 2,28922E-47 which is smaller or equal to 5%. So, the indicator of HDI and RCI is valid to measure social welfare variable. Positive mark (+) on coefficient of *loading factor* HDI shows that the HDI contribution toward social welfare variable goes along with direction, it means if HDI contribution rises so the value of social welfare variable rises, on the contrary, if the HDI contribution descends so the value of social welfare descends. Negative mark (-) on coefficient of *loading factor* RCI shows that the contribution RCI toward social welfare is in different direction, it means if the RCI contribution rises so the value of social welfare variable descends, on the other hand, if RCI contribution descends so the value of social welfare rises.

**Table 1:** Result of *Outer Weights* Variable

Variable	Loading Factor	Sample Mean	Standard Deviation	T Statistics	p-value
Fiscal Decentralisation	1,000000	1,000000	0,000000		
Capital Expenditure	1,000000	1,000000	0,000000		
Economic Growth	1,000000	1,000000	0,000000		
HDI <- Society Welfare	0,902733	0,901393	0,026016	34,698540	2,57014E-79 *)
RCI <- Society Welfare	-0,880798	-0,875692	0,043430	20,280768	2,28922E-47 *)

Source: calculated data

Note: Entries in \*) is significant at 5%.

Structural model or inner model on the conceptual frame which is built based on theories and concepts is called *fit* if it is supported by empirical data. *Goodness of Fit Inner Model* on PLS analysis uses *Stone-Geisser Q-Square test* measurement that is *Q-Square predictive relevance* which is counted based on  $R^2$  value for each endogen variable, which is 1) the variable of Capital Expenditure gained the value of  $R_1^2$  which is 0,006; 2) the variable of Economic Growth gained the value of  $R_2^2$  is 0,044; and 3) the variable of Social Welfare gained the value of  $R_3^2$  which is 0,303. Thus, the value of *Q-Square predictive relevance* is:

$$\begin{aligned} Q^2 &= 1 - (1 - R_1^2) (1 - R_2^2) (1 - R_3^2) \\ &= 1 - (1 - 0,006) (1 - 0,044) (1 - 0,303) \\ &= 1 - (0,994) (0,956) (0,697) \\ &= 0,3377 \end{aligned}$$

It is obtained the value of *Q-Square predictive relevance* that is 0,3377 or 33,77% so the model has weaker predictive value because the variation of variables in the model that are variables of fiscal decentralization, capital expenditure, and economic growth can only explain the variation of social welfare variable that is 33,77%, besides the amount of 66,33% is other variation of variable outside the model. According to Abdillah (2009:63), the low value of *Q-Square predictive relevance* happened that is because of the low value of  $R^2$  is not the main absolute parameter in measuring the accuracy of model. The base of theoretical relationships is the main parameter to explain that causality relationship. So, analysis output model is still worthy conducted inferential to hypothesis proving. This estimation stability is evaluated by using t-statistic test which is obtained from *bootstrapping process*. Based on hypothesis test with t test on every lane partially, it is gained the analysis result as shown on Table 2 that

shows the test output of structural model that is converted into lane diagram which matches with the aim of study.

Fiscal decentralization had no significant effect toward capital expenditure of regencies/cities in the Province of Central Java. It means that fiscal decentralization affects insignificantly toward capital expenditure outcome on APBD of regencies/cities in Central Java Province because of the low PAD proxy and Tax and Non-Tax Output Share toward the Total of Regional Expenditure on APBD of regencies/cities in Central Java Province, so that the impacts toward Capital Expenditure on APBD of regencies/cities in Central Java Province becomes very low. The result of this study supports Oates study (1993) which explained that proportion of public outcome budget in 43 industrial countries is 65% - 90%. It means that the contribution of Direct Expenditure budget toward the total of expenditure budget is relatively big for industrial countries (65% - 90%) and relatively small for developed countries, such as Indonesia (15% - 35%). The result of this study also supports Vasquez's result of study (2006) who explained that the government of China and India conducted fiscal decentralization casually and step-by step, not like other countries including Indonesia that implemented fiscal decentralization in a *big-bang* way and complicated. Based on the result of Klassen Typology there are only 5 regencies in the province of Central Java that was ready to conduct fiscal decentralization per 1<sup>st</sup> January 2001, they are Brebes, Cilacap, Klaten, Kudus, and Semarang because they are located in primary regions. The results of this study also supported Suhendra's result of study (2006) which explained that fiscal decentralization for 5 years since 1<sup>st</sup> January 2001 were still weak because the governments of regencies/cities were still depended on central government.



**Table 2.** Result of Hypothesis

Variable Relationship	Path Coefficient	Standard Deviation	T-Statistics	p-value
FiscDec -> CapExp	0,074286	0,068899	1,078180	0,2824720
FiscDec -> EcGrowth	-0,175335	0,081039	-2,163590	0,03188366 *)
FiscDec -> SocWelf	0,488138	0,083317	5,858783	0,0000000233792 *)
CapExp -> EcGrowth	-0,101261	0,071682	-1,412646	0,159577282
CapExp -> SocWelf	0,069339	0,071100	0,975242	0,33081783
EcGrowth -> SocWelf	-0,156687	0,078798	-1,988465	0,04835568 *)

Source: calculated data.

Note: Entries in \*) is significant at 5%.

Fiscal decentralization had significant effect and negative relationship toward economic growth of regencies/cities in Central Java Province. This negative direction shows that the rise of fiscal decentralization will cause economic growth descent in regencies/cities of Central Java Province. This means that in regional autonomy era, fiscal decentralization as fiscal decentralization in outcome side that is funded mainly through transfer to regions, so the autonomy essence of regional fiscal management is focused at discretion (freedom) to spend funds and expenditure activities of officials who are from outside of regency/city in Central Java Province so that the economic growth of regencies/cities in Central Java Province decreases. It is shown by negative net export. Besides, fiscal decentralization is conducted in a *big-bang* way and unarranged steps without seeing the readiness, economic condition, and characteristics of regencies/cities in Central Java Province. The result of this study supports the results of study from Ismail (2004), Adi (2005), Suhendra (2006), Vazques (2006), Akai *et al* (2007), Wibowo (2008), also Priyarsono *et al* (2010).

Fiscal decentralization had significant effect and positive relationship toward the wealth of society of regencies/cities in Central Java Province. This positive direction shows that the rise of fiscal decentralization affects to the rise of social welfare in regencies/cities of Central Java Province. It means that efficiency aspect is *raison*

*d'etre* to fiscal decentralization. Because the preference of each individual toward public goods is different, so in a decentralized fiscal system, each individual can choose to stay in a suitable community or society with their preference in order to maximize the wealth of society. Economic argumentation about efficiency comes from the fact that government of regencies/cities in Central Java Province can fulfill much importance and opinions from its society and it can allocate many resources efficiently compared with central government. This study output supports the study result of Suryanto *et al* (2005:67-68), Nasution (2007), and Widhiyanto (2008) because fiscal decentralization per 1<sup>st</sup> January 2001 has increased the number of HDI in whole regencies/cities of Central Java Province in 2004 until 2008 even though it still affects the rise of RCI, the portion of poor citizens which are still 20%, and the number of Gini index (Gini ratio) of cities that increase.

Capital expenditure on APBD of regencies/cities had no significant effect toward economic growth of regencies/cities in Central Java Province. It means that the portion of Indirect Expenditure that most of it is for Official Expenditure and budgeting deviation on APBD of regencies/cities in Central Java Province effect the low portion of Capital Expenditure toward the Total of Regional Outcome on APBD of regencies/cities in Central Java Province. The allocation of Capital Expenditure on APBD of regencies/cities has not been suitable yet

with the needs and priorities of each region so that it causes Capital Expenditure on APBD of regencies/cities in Central Java Province becomes unproductive for long-term investment. The policy of government budget becomes contraction toward economic growth of regencies/cities in Central Java Province. Thus, the economic growth that happens in regencies/cities of Central Java Province is caused by private investment role. The founding of study supports Priyarsono *et al* (2010) and Badrudin (2011), it is because the ability of capital expenditure on APBD of regencies/cities in Central Java Province is limited so that it effect very low toward economic growth of regencies/cities in Central Java Province in 2004 until 2008.

Capital expenditure on APBD of regencies/cities had no significant effect toward social welfare of regencies/cities in Central Java Province. It means that Capital Expenditure as a component of Direct Expenditure on Total of Regional Outcome that will be allocated by the local government to fund activities of public facilities development such as road, bridge, telecommunication, electricity, school, hospital, market, and other public facilities that are used by society will become obstacle. It is caused by 6 characteristics of Capital Expenditure and the allocation of Capital Expenditure on APBD of regencies/cities that have not been suitable with needs and each regional priority so that it causes Capital expenditure on APBD of regencies/cities in Central Java Province becomes unproductive and for long-term investment. That is why, the ability Capital Expenditure on APBD of regencies and cities becomes limited in affecting social welfare of regencies/cities in Central Java Province. This result of study supports Badrudin's study (2011)

Economic growth of regencies/cities had significant effect and negative relationship toward social welfare of regencies/cities in Central Java Province.

This negative direction shows that the rise of economic growth affects toward the descent of social welfare of regencies/cities in Central Java Province. It means that all local governments of regencies/cities in Central Java Province when arranging targets of economic development output, they always use one of assumptions, which is the achievement of economic growth in specific percentage. If the targets of economic growth can be achieved or even passed, so it is said that the local governments of regencies/cities succeed to manage the governing activity, on the other hand, if the targets of economic growth cannot be achieved, so the local governments have not succeeded yet in managing the governing activity, even they have failed. The results of economic development does not only orientate on the achievement of numbers in specific economic growth. The success of economic development is not only decided by the speed of economic growth, but more to the rise of social welfare. That is why, the local governments of regencies/cities in Central Java Province need to differ the meaning between economic growth and economic development because those two terms are different in definition also different in the impacts that are caused toward the economy of regency/city. Thus, economic growth that happens in regencies/cities of Central Java Province does not always create wealth to society. This result of study does not support to study of Nasution (2007), Sasana (2009), and Badrudin (2011).

## CONCLUSION

This study is about the effects of fiscal decentralization toward capital expenditure, economic growth, and society welfare of regencies/cities in Central Java Province. Based on the research output analysis and discussion the conclusion is fiscal decentralization affected insignificantly toward capital expenditure but affected significantly toward economic growth and social

welfare of regencies/cities in Central Java Province, capital expenditure on APBD of regencies/cities affected insignificantly toward economic growth and social welfare of regencies/cities in Central Java Province, and the economic growth of regencies/cities affected significantly toward social welfare of regencies/cities in Central Java Province.

Based on the conclusion produced in this study, there are some suggestions that are expected to be useful to practical importance and further studies, that is: to succeed the aim of economic development of regencies/cities in Central Java Province in regional autonomy era and fiscal decentralization, the local governments of regencies/cities or Central Java Province have to be able to manage governing management with integrity and professionalism. Besides, APBD have to be managed transparently, efficiently, effectively, accountable, and

participative that have to be reflected in every implementation of regional finance management policy, not only in RAPBD arrangement, APBD deciding process/ APBD implementation, but also APBD responsibility. The further study connected with this theme is suggested to add private investment variable so that it will make deeper the discussion of analysis and implication sharpness. It is based on the fact that capital expenditure on APBD of regencies/cities affected insignificantly toward economic growth and social welfare, it was because capital expenditure on APBD of regencies/cities in Central Java was not productive for long-term investment so that the local government budget policy of regencies/cities in Central Java Province became contraction toward the economic growth and social welfare of regencies/cities in Central Java Province.

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