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The Impact of Fiscal Decentralisation on Income Inequality and Labor Market Performance in East Kalimantan Province, Indonesia: A Structural Model Analysis

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Abstract

This paper elaborates the effects of fiscal decentralisation in Eastern region of Indonesia by taking East Kalimantan Province as focused area. The main objective of this paper is to analyse the impact of natural resource revenue and capital expenditure on welfare indicators (income inequality and labor market outcome approached by labor absorptions) directly and indirectly through sectoral economic performance. Here, structural model of econometrics technique is used to find those effects among variables. Empirical results from this research show that fiscal decentralisation is able to reduce the degree of inequality particularly from the expenditure performance rather than income side. This is indicated by the negative findings on the effects of direct capital expenditure on the Gini Index. These findings are consistent with the hypothesis and significant in terms of statistical calculations. The expenditure side is also able to increase the ability of the labor market to absorb labor force in large numbers, although not significant statistically.

Keywords: Fiscal decentralisation; income inequality; labor; Gross Domestic Product

1. Introduction

Indonesia is one of country among many countries which has implemented decentralisation process on its development since 2001. It is practiced based on National Regulation No. 33 Year 2004 and National Regulation No 32/2004. This system gives all regions (regencies and municipalities) at all provinces opportunity to receive large portion of budget from Central Government based on its natural resources and tax revenue (non-natural resources base).

This study elaborates the effects of fiscal decentralisation in Indonesia by taking Eastern Indonesia as the focus area, emphasizing on East Kalimantan province, which is one among three richest provinces in this huge country. It is interesting to connect whether the great acceptance of revenue from natural resources that owned by this province under the flag of fiscal decentralisation regulation has a positive effect for local welfare indicators. As an example, declining income inequality, rising labor market outcome performance and improving an output of economy by sector dramatically.

Empirically, the relationship between decentralization and a decrease in inequality is quite controversial. In the context of the revenue, refers to the study of Tsui (1996), Qiao et al. (2002), Rodriguez-Pose and Gill (2003), Bonet (2005), Sepulveda, et al. (2011), Pike, et al. (2012) and Nguyen, et al. (2012), they all find a negative relationship, while other studies such as from Shankar and Shah (2001), Gil, et al. (2002), Hong (2003), Baron and Meisel (2003), Kim, et al. (2003) reveal the indications that decentralisation had increased the incidence of income inequality. In Indonesia, Dyah (2010) discovers a negative result, while another study from Zakaria (2013) shows a positive results

The effect of fiscal decentralization, on the expenditure side, to the inequality of income and employment also performed. The positive effects of capital expenditure on labor market investigated by Dipendra (1998), Sodik, et al. (2007), Fan, Yu & Jitsuchon (2008), Benos (2009), Hasan (2010), Hidayat (2013) and Aladejare (2013). But the study of Bagdigen & Centitas (2003) in Turkey could not find a clear view about this issue. Meanwhile, Aritenang (2009) on the case in Indonesia has found that government spending has a negative influence on employment. It is caused by a high proportion of personnel expenditure rather than capital expenditure which is expected could be expanding the growth of economic sector / private sector inside the regions.

In the case of Indonesia, studies linking the issue of fiscal decentralisation on the level of economic progress are also made by Komarulzaman & Alisjahbana (2006). They tested the effects of revenues from natural resources and found that the revenue-sharing is contributing positively on economy. These results also support Buser (2011) and Nguyen, et al studies. (2012). Furthermore, Sinaga, et al. (2005) and Faridi (2012) find the implications of fiscal decentralisation on labor absorption is positive. On the basis of empirical studies, it is important to examine these relationship in the context of decentralised Indonesia..

Income inequality in East Kalimantan (Kaltim) seems to be the key issues worth examining further. This is due to the trend of income inequality (using the Gini index) in this region becomes increasingly prevalent,

Table 2. Indirect Effect on Income Inequality (Y5)

No	Indirect Effect	Parameter Value (mediated by):			
		Y4	Y1 Y4	Y2 Y4	Y3 Y4
1	Natural resource revenue (X1) → Income Inequality (Y5) through:	- 0.016414	0.028285	- 0.00042	0.00822
2	Capital Expenditure (X2) → Income Inequality (Y5) through:	0.000012	0.003992	0.00019	0.00459
3	Investment (X3) → Income Inequality (Y5) through:	0.0088	-0.00324	- 0,00195	0,01227
4	Road Infrastructure (X4) → Income Inequality (Y5) through:	- 0.000116	0.005451	0.00109	- 0.00456
5	GDP of primary sector (Y1) → Income Inequality (Y5) through:	0.01473			
6	GDP of industrial sector (Y2) → Income Inequality (Y5) through:	-0.00122			
7	GDP of tertiary sector (Y3) → Income Inequality (Y5) through:	0.026506			

Source: Calculated by authors based on Appendix 1 results

Table 3. Indirect Effect on Labor Market Outcome (Labor Absorption) (Y4)

No	Indirect Effect	Parameter Value (mediated by):		
		Y1	Y2	Y3
1	Natural resource revenue (X1) → Labor absorption (Y4) through:	0,4876	-0.0071	0.1416
2	Capital Expenditure (X2) → Labor absorption (Y4) through:	0,0688	0.0031	0.0790
3	Investment (X3) → Labor (Y4) through:	-0,0558	-0.0337	0.2115
4	Investment (X4) → Labor (Y4) through:	0,0939	0.0187	-0.0786

Source: Calculated by authors based on Appendix 1 results

4. Conclusion

This study is succeed to capture some important findings: First, we found that fiscal decentralisation in East Kalimantan was able to reduce the degree of inequality particularly from the expenditure performance rather than income. This is indicated by the negative findings on the effects of direct capital expenditure on the Gini Index. These findings are consistent with the hypothesis and significant in terms of statistical calculations. The expenditure side is also able to increase the ability of the labor market to absorb labor force in large numbers, although not significant statistically.

Indirectly, our study also found that fiscal decentralization was able to play a positive role in improving the welfare of local people through the performance of the primary sector and industrial industry compared to the tertiary sector. This was indicated by findings which was generating positive parameters indirectly if the fiscal variables multiplied by the parameter of all economic sectors directly on the welfare indicators.

At the end, the debate about whether the implementation of fiscal decentralisation has a positive contribution for local welfare based on this study can be proven, especially in the case of decentralised Indonesia (taking the case in East Kalimantan as a sample). The local government should use its power of authority to ensure the ability of budgeting concerning public spending could run rapidly focusing on improving the welfare of the poor groups and underdeveloped people. This, in the long term, is expected to reduce disparity among social level and income inequality itself which can be damaging the quality of economic growth and development entirely.

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