International Journal of Business and Management Invention
ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X
www.ijbmi.org
Volume 1 Issue 1 ǁ December. 2012 ǁ PP.16-21

Effect of Fiscal Autonomy and Economic Growth on Local Financial Performance (A Study on Local Government Of Papua Province)

[1]James Paul Alfred Renyaan
[2]Salim Ubud, [3]M.S. Idrus, [4]Djumahir

[1]Economy Faculty of Cenderawasih University, Jayapura Papua Indonesia
[2,3,4]Economy Faculty & Business of Brawijaya University Malang Indonesia

ABSTRACT: *The purpose of this study is to investigate effects of fiscal autonomy and economic growth on local financial performance in Papua Province. Data collection is done using the data subject and the documentary data. This study uses descriptive analysis to determine descriptive characteristics for each indicator variable of fiscal autonomy, economic growth and local financial performance. Meanwhile, to test the relationship hypotheses among the variable, this study uses analysis tools with Partial Least Square (PLS) method. Results from this study indicate that when managed fiscal autonomy and economic growth are able to improve regional financing performance by considering such factors as financial efficiency and regional financing effectiveness. While economic growth is not managed properly can reduce the area of financial performance by considering the factors of efficiency and effectiveness of local finance.*

Keywords— *Fiscal Autonomy, Economic Growth, Local Financial Performance*

I. INTRODUCTION

Regional autonomy in Indonesia is viewed as a strategy to respond local communities' demands on three main issues which are sharing of power, distribution of income, and independence of management system. Mardiasmo (2001) explains that decentralization as a strategy to build up the local economy in order to strengthen national economy to face the free trading era. For the areas which are rich in natural resources, financial balance between center and region is a requirement that must be fulfilled as a principle of justice against resources exploitation they have and meantime for the areas that have less natural resources wealth, the amount of funds balance they receive from central government is surely to be inadequate amount of funds that they need in order to organize the increasing complex government activities. It then becomes polemic which is fundamental issue to local and central government in implementing local autonomy because the authority granted by the central government is meaningless if it is not followed by the financial ability to fund the authority implementation.

The issuance of UU/22/1999 (later is revised to be UU/32/2004) about Local Government and UU/25/1999 (later is revised to be UU/33/2004) about Financial Balance between Central and Local Government, is a response on local government wishes to perform governmental tasks independently, expressing aspirations, equal distributed in financial balance and the freedom to manage financial resources. In the past few decades, it tended to be centralized, undemocratic, apriority on local aspirations, and generalizing the condition of all the regions.

Therefore, in implementing a broad local autonomy, real and accountable, local capacity is needed to excavate their own financial resources backed by a financial balance from central and local government. As stated by Koswara (2000) that the main characteristics that show an autonomous region is capable in doing autonomy lies in the financial capabilities. This means that the autonomous region must have authority and ability to excavate their own financial resources, manage and use their own finances that are sufficient enough to finance the local government implementation. Additionally, Insukindro *et al.* (1994) suggests that Local Own Revenue (PAD) can be seen as an indicator or criterion in measuring a region dependence to central government which in principle is the greater contribution of Local Own Revenue to Local Revenue and Expenditure Budget (APBD), it shows the less dependence of local government on central government in financial relationship of central and local government.

Empirical phenomena in the field have given a few lessons to be learned which is Papua revenue growth from 2001 to 2005, with average fluctuating growth of 133.26% per year. The highest growth in 2002 was amounted to 158.42%, and then it declined in 2003, amounted to 115.81%. In 2004, it increased by 137.54 and in 2005, it decreased by 121.28%. It also reveals the APBD growth of Papua Province from 2001 to 2005, with a 148.09% growth rate per year. The highest growth in 2002 was amounted to 263.29% and decreased in 2003 by 118.31%, decreased in 2004 to be 101.11% and increased in 2005 to be 109.64%. From the explanation above, it can be seen that the average fiscal capacity Papua Province is still low even though the growth is quite high. In this case, PAD cannot be relied as autonomy funding source to finance government activities because the fiscal policy has not given any favors to society's incomes. Therefore it is necessary to analyze the extent of the financial capacity of Papua Province in financing the government activities and its increasing relationship along with regional economy development. One indicator to determine the economic condition a region is shown by PDRB; defined as the sum of value added generated by all business units in a region, or a total value of final goods and services produced by the entire economic unit, and it shows that Papua Province PDRB also increased from year to year, with an unequal proportion. This can be shown in the growth rate of PDRB as (Table 1).

Table 1. PDRB Growth of Papua Province, 2000-2004

No	Sector	2000	2001	2002	2003	2004
1.	**Agriculture**	4,97	8,57	5,07	6,10	2,62
2.	**Mining and Quarrying**	5,50	8,89	21,08	6,97	6,67
3.	**Industry**	-8,45	2,52	7,91	10,04	0,46
4.	**Electricity and Water**	8,36	9,07	8,23	8,79	7,74
5.	**Building (Construction)**	5,15	4,40	11,13	7,35	6,56
6.	**Trade, Restaurant and Hotel**	7,30	6,76	9,62	8,40	7,38
7.	**Transportation and Communication**	8,53	11,95	15,97	18,67	15,82
8.	**Finance, Leasing, Company's Service**	71,36	-35,53	3,96	4,48	15,82
9.	**Services**	4,65	10,53	8,78	2,44	4,40
Papua		6,61	5,67	8,10	7,55	6,63

Sources: Dispenda Data of Papua Province, processed, 2008.

Based on Table 1, it can be seen that the PDRB growth in Papua Province shows fluctuating conditions from 2000 to 2004, in which the lowest growth occurred in 2001 amounted to 5.67 and the highest growth was in 2002 amounted to 8.10. However, by considering the high level of local fiscal revenue growth is not accompanied by high economic growth so that the government role on economic growth in Papua Province has not yet been optimal.

Local financial management is part of Local Government Management other than Human Resources Management and Technical Management of each institution relating to the public service, or known as Public Service Management and Local Development Administration Management.

Akbar (2002) explains that local financial management looks for local funding sources through the structured potencies and capabilities through systematic planning stages, the efficient and effective use of funds and punctual reporting. There are four embedded dimensions from local finance, which are: (1) The dimensions of rights and obligations, (2) The dimensions of objectives and planning, (3) The dimensions of implementation and public services, and (4) The dimensions of value for money and goods (investment and inventory). Public services management is the reflection of authority responsibilities of local autonomy from the central government which consists of: Public Administration; Agriculture; Fisheries and Marine Resources; Mines and Energy; Forestry and Plantation, Industry and Trade; Cooperatives; Investment; Employment; Health; Education and Culture; Social; Layout Structure; Settlements; Public Works, Transportation; Environment; Population; Sports; Tourism, and Land. It is usually reflected by the local departments and local government organizational structures associated with the breadth and scope of those tasks.

Devas, *et al.*, (1989) cites that local financial goals are (1) Accountability. Local government must be accountable for the financial duty to the institution or the person who is concerned and legitimate. Agency or person, in this case, is central government, Parliament, Head of Region, communities and other interest groups (NGOs), (2) Meeting financial obligations. Local finance should be laid out in such a way so that it is able to pay off all financial ties, both short and long-term, (3) Honesty. Financial issues should be handed to the professional and honest employees, thus it is reducing the opportunity for fraud, (4) The effectiveness and usefulness of local activities. Procedures for local financial arrangements should be such a way so that it is able to allow any planned and implemented programs to achieve the objectives with the lowest costs and maximum results, (5) Control. Local finance manager, Parliament and controlling functional apparatus should do controlling so that objectives can be achieved. They should always monitor through information access about financial accountability.

Akbar (2002) mentions that the management functions are divided into three main stages, they are: planning process, implementation phase, and controlling or monitoring phase. Therefore local financial management function consists of elements duties that include the following tasks: (1) Allocation of local economic potential resources, (2) Revenue and Expenditure Budgetary Process, (3) Performance measurements and standards, (4) Budget implementation in accordance with Accounting Principles, (5) Local Chief Financial Accountability Report, and (6) Local finance controlling and monitoring.

Some law regulations as the reference for local financial management have been issued previously. Those are UU/17/2003 of State Finances, UU/1/2004 of State Treasury, UU/15/2004 on State Management and Financial Responsibility Audit, and UU/25/2004 of National Development Planning System. Local financial management principles include three principal cycles, which are: (1) planning, (2) implementation, (3) reporting and accountability. The principles underlying the local financial management are transparency, accountability and value for money.

Sarundajang (2000) mentions that autonomy is as self-government, self-sufficiency and the actual independency, autonomy remains is the upper limit that does not exceed the authority of central government who hands over the issues of local government. Legally of course local governments are not like sovereign nations. Condition may be imposed upon them from above. State government may insist upon the consolidation of local government.

Decentralization, more broadly, is defined as the legislative authority transfer (delivery), judicial, and or administrative from higher to lower government levels (White, 1959 in S. N. Jha & P. C. Mathur, 1999). On the other hand, Cheema and Rondinelli (1983) interpret decentralization as "... The transfer of planning, diction-making, or administrative authority from the Central Government to its field organizations, local administrative units, semi-autonomous and parasitical organizations, local governments, or non-government organizations."

It means that decentralization is the transfer of planning, decision-making, or administrative authority from the central to the organizations below, local administrative units, semi-autonomous organizations, local governments, or non –government.

Behrman, *et al.* (2003) and Sidik (2002) state that the decentralization encouragement that occurred in various countries of the world, especially developing countries, are affected by several factors such as the background or experience of a country, its role in the world globalization, declining in economic growth, demands for changes in community service level, disintegration signs, and the number of failures experienced by central government in delivering effective public services. Problems that arise from a centralized management include: (1) planning aspect, dominant central role in setting priorities (top down) in the region and less involving stakeholders, (2) implementation aspect, subject to various directions in the form of guidelines and technical guidance from the center, and (3) monitoring aspect, the number of functional oversight institutions, such as BPKP, Department Inspector General, Irjenbang, Regional Inspectorate that can be overlapped each other (Boediono, 2002; Sidik, 2002, and, Widjaja, 2002).

Fiscal balance between central and local governments determines that the local revenue in decentralization implementation consists of local revenue and finance. Local revenue includes all cash revenue through the local general treasury account that adds equity funds smoothly and is the right for local government in a fiscal year that does not need to be paid back by the region.

Revenue is directly derived from the mechanisms of local taxes and charges or other fees charged to the public. Justice or fairness in taxation related to the horizontal equity and vertical equity principles. The horizontal fairness principle requires people in similar positions should be treated equally. While the vertical fairness principle is based on the concept of required taxes capabilities/ retribution to pay, means that for the society who is capable to pay will be charged for high taxes/ retribution. Local Own Revenue is one form of fiscal decentralization to provide revenue sources for regions that can be explored and to be used along with its own potential.

Chourmain and Prihatin (1994) explain that in macroeconomic, there are some discussions of general theories from whole economy symptoms. This especially concerns on economic events related to general price level; overall supply and demand related to population, overall amount of production, number of job opportunities and employment as well as work placing of entire work force in society. So in whole, macroeconomic theories discuss overall symptoms and events in economic life, their relationships to each other, either they are causal or functional relationships. This theory is in contrast with micro theory which is a theory that discusses events or causal relationships among multiple functional and economic events that are particular. Particular sense here is on limited or specific reviews as on particular person, particular family, particular company, and so on. Thus, the major studies on the micro theory is limited on supplies, goods and services, prices, wages, incomes from an economic organism within household, family or company scopes.

Economic growth is the increase in output per capita in long-term. This definition emphasizes three things, which are: process, output per capita and long-term. The process describes economy development of the economy from time to time that are more dynamic; output per capita relates to total output aspect and population aspect, while long-term trend shows economic changes tendency within a certain period driven by internal economy process (self-generating). Economic growth is also interpreted simply as increasing in total output in long-term, regardless of whether the increase is smaller or larger than the population growth rate or whether it runs along with economy structure growth.

Bernardin and Russel (1993) define performance as: "...the record of outcomes produced on a specified job function or activity during a specified time period”. From the definition, it can be concluded that the achievement of high performance is an achievement for every organization and its unit organization, therefore every organization is required to constantly improve its performance.

Siegel and Marconi (1989) mention that performance appraisal is a periodic determination of operational effectiveness of an organization and its employees based on objectives, standards and criteria that has previously established (in Tangkilisan, 2003). Performance measurement is very important for the improvement or advancement of an organization and including its employees to generate better performance. According to Gazpersz (2003), in modern management, measurement on the facts will result in data, which then if it is properly analyzed, the data will provide accurate information, then that information will be useful to increase the managers’ knowledge in decision-making or management actions to improve organization’s performance.

The performance of local government is automatically to be overall performance or results during the implementation of local autonomy. In order to achieve performance level as expected, it is surely necessary to formulate performance plan that includes elaboration of performance goals and programs that have been set out in local government strategic plan. Based on the strategic plan, it can be measured how extent the local government has been able to achieve the goals or targets (performance) that have been set with both quantitative and qualitative indicators. Indicators that can be used to measure the performance are categorized into groups: (a) inputs, (b) outputs, (c) outcomes, (d) benefits, (e) impacts (in Simbolon, 2003).

II. METHODS

The data used in this study are primary data which are (1) subject data (respondent reports, individually or group) and (2) documentary data (notes, memos, reports, meetings notes) and others to be used as basic material for analysis. While secondary data are obtained from the fiscal autonomy, economic growth and local financial performance data. Population and samples data are taken from the entire reports issued SKPD that handles fiscal, economy and financial in regions. They are: 1) Papua Province Revenue Department, 2) Papua Province Central Statistics Bureau, and 3) Papua Province Financial and Asset Management Bureau, since Papua integration into the Republic of Indonesia up to recent moment. The data analysis technique uses (1) Comparative Budget Statement (CBS) either vertically or horizontally to measure the ratio of expenditure growth from year to year, (2) Fiscal autonomy degree, to measure how big the dependency of local government to central government in financing the local construction.

III. RESULTS

3.1. Testing Goodness of Fit Model

The results of Goodness of Fit model analysis using predictive value-relevance (Q^2) shows the predictive value-relevance of 0.900 or 90%, so that the model has a relevant predictive value of 90% or in other words, the information contained in the data can be explained 90% by the model, while the remaining 1% is explained by other variables (which is not contained in the model) and error.

3.2. Testing Linearity Assumption

PLS analysis result requires relationship among variables is linear. Assumption of linearity uses the Curve Fit declared by linear variable if it fulfills one of the two following possibilities: (1) a significant linear model (linear model sig <0.05), (2) the linear model is not significant and whole model may be also not significant (sig models linear >0.05 and in addition to the linear model sig >0.05) can be seen in Table 1.

Table 1. Linearity Assumption Testing

Variable Relationship		Linear Model Testing	Linier Model Sig	Conclusion
X_1	Y	Model is Linear and Significant	0.001	Linear
X_2	Y	Model is Linear and Significant	0.000	Linear

(Source: Primary Data, processed, 2012)

3.3. PLS Inner Model

The results of hypotheses analysis by t-test (T-statistic) for each direct influence path partially can be seen in Table 2.

Table 2. Hypotheses Testing Results in Inner Model: Direct Influence

Variable Relationship	Path Coefficient	T-stat	p-value
Local Fiscal → Local Financial Performance	0.537	2.926	0.003*abs
Economic Growth → Local Financial Performance	-1.457	8.14	0.000*rel

(Source: Primary Data, processed, 2012)

The results of hypothesis paths testing can also be seen in the chart on the following lines.

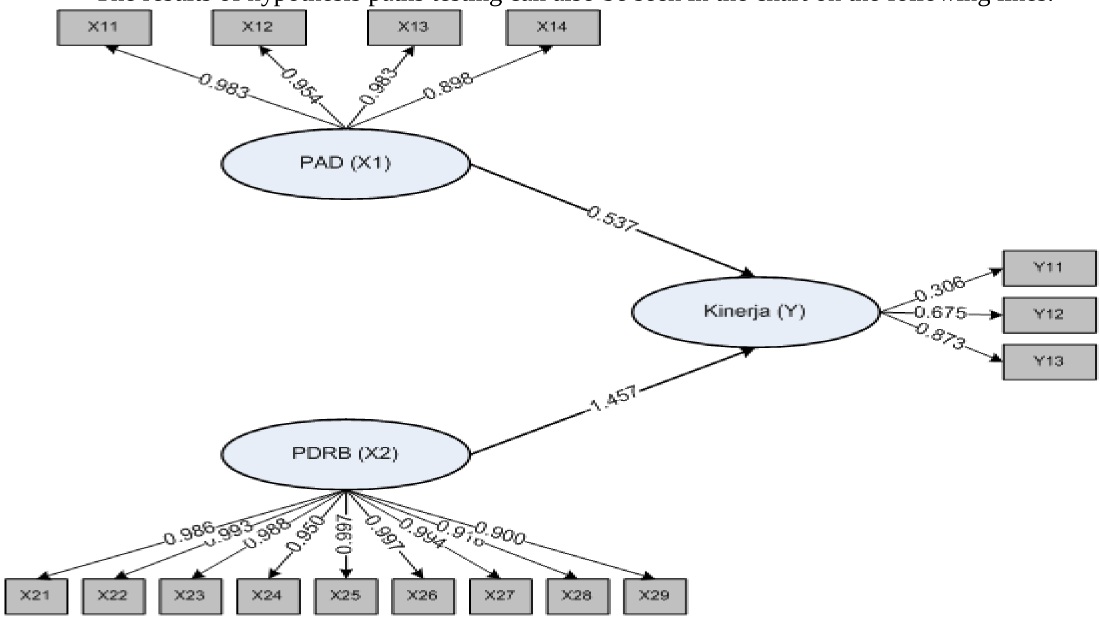

Figure 1. Path Diagram

IV. DISCUSSION

4.1. Effect of Fiscal Autonomy on Local Financial Performance

The direct influence analysis results of fiscal autonomy on local financial performance obtain the value of direct influence coefficient of positive and significant (r = 0.537, p-value = 0.003). Because p-value <0.05, it can be concluded that there is enough empirical evidence to accept the hypotheses that the better improvement in the fiscal autonomy will improve the local financial performance, since the positive coefficient indicates the better fiscal autonomy will improve more the local financial performance.

Description analysis, generally fiscal autonomy is perceived significant. Significant fiscal autonomy is caused by variables formers, i.e. taxes, fees, interest, and local enterprises profit that are significant. Tax is an important indicator that can provide the greatest contribution to fiscal autonomy of Papua Province Government. Empirical facts show that fiscal autonomy is less respect, so that local government needs to define some steps in strengthening local fiscal.

This indicates that the more improving fiscal autonomy as reflected by high taxes and interest rates, will lead more in improving local financial performance as reflected by high autonomy and effectiveness and low efficiency. Conversely, if the worse fiscal autonomy, as reflected by the taxes and interest, will result less ability in improving the local financial performance as reflected by the low value of independence and efficiency and high effectiveness value.

The results of this study support previous empirical findings of Tapsoba (2010). He questioned whether there are any fiscal rules which mold fiscal behavior in developing countries. Therefore, the policy effect on fiscal discipline in 74 developing countries over the period 1990-2007 found that the structural fiscal balance have a significant positive impact on financial performance, for various specifications and varying along with the country's characteristics.

4.2. Effect of Economic Growth on Local Financial Performance

The direct effect analysis of economic growth on local financial performance results the coefficients obtained by the direct influence is -1.457 with p-value of 0.000. Because p-value is <0.05, it can be assumed there is enough empirical evidence to accept the hypothesis that increasing economic growth will improve the local financial performance. The negative coefficient indicates the higher the value of economic growth, the lower the local financial performance. When it is found that a significant and negative effect of economic growth on local financial performance, it indicates the increasing economic growth, as reflected by the existence of high buildings such as hotel and restaurant, will affect on the more it is less able in improving local financial performance as reflected by low independency and efficiency yet high effectiveness. On the contrary, declining economic growth, as reflected by high buildings such as hotel restaurants, will be able to improve local financial performance, as reflected by the low independence and efficiency yet high effectiveness.

The results of this study support previous empirical findings from Weingast (2009), which concluded that: 1) local fiscal implications for the region's financial performance, 2) fiscal incentives affect financial performance. And this study results do not support previous findings of Jomes, Sanguinetti and Tommasi (2000), which is, firstly, determined in two stages: the first is in every province and the second is in the entire political unit. In the second stage, national government has a greater incentive than the province governments to internalize negative externalities of fiscal recklessness. Considering that discipline party is quite strong, the president is able to induce the governor from his own party to internalize some externalities to greater extent than the governor's opposition. In Argentina, fiscal issue has become party responsibility, but it can only be done for different reasons from those identified in studies of the OECD countries.

V. CONCLUSION

Fiscal autonomy during local autonomy period is able to improve local financial performance. This is caused by the sector of taxes, fees, profit enterprises or interest and other income for local financial performance, which is considered to strengthen local fiscal capacity so that fiscal autonomy fluctuations can be followed by the fluctuations of local financial performance.

Economic growth can not improve local financial performance, as can be explained by sector: agriculture, mining and quarrying, industry and manufacturing, electricity and water, construction, trade, hotel and restaurant, transportation and communication, finance and leasing, and services that support improving local financial performance. Along with the increase in local government’s expenditure, it will decrease local economic growth. Decreasing economic growth gives impact on increasing Local Own Revenues, so that it strengthens local fiscal and ultimately affects local financial performance. This means that if local government intends to improve financial performance, it should be in line with decreasing economic growth.

REFERENCES

[1]. Akbar, B. 2002. *Fungsi Manajemen Keuangan*. Booklet Publikasi BPK. No. 87. Bulan Oktober. Jakarta

[2]. Behrman, J. R., A. B. Deolalikar and L.Y. Soon. 2003. The Role of Decentralization in Promoting Effective Schooling in Developing Asia. *Asian Development Review*. 20 (1):57-99.

[3]. Bernardin, H. J. and J.E.A, Russell. 1993. *Human Resource Management: An Experiential Approach*, McGraw-Hill, New York.

[4]. Cheema. G. S. 1983 and Dennis A. R. (eds).1983. *Decentralization and Development: Policy Implementation in Developing Countries*. Beverly Hills: Sage Publications.

[5]. Imam, C. P. 1994. *Pengantar Ilmu Ekonomi*. Proyek Pembinaan dan Peningkatan Mutu Tenaga Kependidikan, Dikti, Depdikbud. Jakarta.

[6]. IInsukindro, Nur, dan Bambang Supomo. 1994. *Peranan dan Pengelolaan Keuangan Daerah Dalam Usaha Peningkatan PAD, KKD*. FR-UGM. Yogyakarta.

[7]. Koswara. 2000. Menyongsong Pelaksanaan Otonomi Daerah Berdasarkan UU No. 22 Tahun 1999. *Analisis CSIS*. No. 1 Tahun XXIX

[8]. Mardiasmo. 2001. *Otonomi dan Manajemen Keuangan Daerah*. Andi. Yogjakarta.

[9]. Devas, N. (ed) 1989. *Financing Local Government in Indonesia*, Athens: Ohio University Press,.

[10]. Sarundajang, S.H. 2001. *Arus Balik Kekuasaan Pusat ke Daerah*. Pustaka Sinar Harapan. Jakarta.

[11]. Simbolon. A.2003. *Laporan Akuntabilitas Instansi Pemerintah (LAKIP).* Dispenda. Jakarta.

[12]. Tangkilisan, H. N. S. 2003. *Manajemen Modern untuk Sektor Publik: Strategic Management, Total Quality Management, Balanced Scorecard, Scenario Planning.* Balairung & Co. Yogjakarta.

[13]. S.N.Jha & P.C.Mathur, 1999. *Decentralization and Local Politics*. New Delhi. Sage Publications.

[14]. Gaspersz, V. 2003. *Sistem Manajemen Kinerja Terintegrasi Balance Scorecard dengan Six Sigma untuk Organisasi Bisnis dan Pemerintah*. Gramedia Pustaka Utama. Jakarta.