

THE IMPACTS OF BUDGET DECENTRALIZATION ON ECONOMIC GROWTH AND LOCAL GOVERNMENT PERFORMANCE

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ABSTRACT

The implementation of decentralization can cause an expansion of authorities for local government and also be expected to encourage the improvement of local financial capability. Besides that, decentralization tends to allow larger authorities for local government to manage and maintain the local area, including financial management, so it finally enables local government to be easier to increase their creativity in developing the local potential. This research is aimed to analyze the impacts of budget decentralization on supporting economic growth and improving local government performance of residences/cities in East Java. Research population is the whole local government of residences/cities in East Java, consisting of 29 residences and 9 cities. Analysis technique used in this research is partial least square (PLS). The results show that in East Java: (1) Budget decentralization of residences/cities provides significant impact on economic growth (2) On the contrary; budget decentralization of residences/cities does not provide significant impact on local government performance. (3) Economic growth in residences/cities statistically provides significant impact toward local government performance. (4) Budget decentralization of residences/cities statistically provides significant impact on local government performance through economic growth.

Key words: Budget Decentralization, Economic Growth, Local Government Performance.

PENGARUH DESENTRALISASI ANGGARAN TERHADAP PERTUMBUHAN EKONOMI DAN KINERJA PEMERINTAH DAERAH

ABSTRAK

Desentralisasi dapat memperluas kewenangan bagi pemerintah daerah yang diharapkan mampu mendorong peningkatan kinerja keuangan pemerintah daerah. Desentralisasi juga cenderung memberikan otoritas lebih besar bagi pemerintah daerah untuk mengelola dan menangani wilayah daerahnya, termasuk manajemen keuangan sehingga mampu meningkatkan kreativitas dalam mengembangkan potensi daerahnya. Penelitian ini bertujuan untuk menganalisis dampak desentralisasi anggaran dalam meningkatkan pertumbuhan ekonomi dan kinerja pemerintah daerah kabupaten/kota di Jawa Timur. Populasinya terdiri atas seluruh pemerintah daerah di Jawa Timur yang terdiri atas 29 kabupaten dan 9 kota. Teknik analisis yang digunakan adalah partial least square (PLS). Hasil penelitian menunjukkan bahwa di kabupaten/kota Jawa Timur: (1) desentralisasi anggaran memberikan dampak signifikan terhadap pertumbuhan ekonomi (2) Sebaliknya, anggaran desentralisasi tidak memberikan dampak yang signifikan terhadap kinerja pemerintah daerah. (3) pertumbuhan ekonomi secara statistik memberikan dampak signifikan terhadap kinerja pemerintah daerah. (4) desentralisasi anggaran secara statistik memberikan dampak yang signifikan terhadap kinerja pemerintah daerah melalui pertumbuhan ekonomi.

Kata Kunci: Desentralisasi Anggaran, Pertumbuhan Ekonomi, Kinerja Pemerintah Daerah.

INTRODUCTION

Transformation on governmental structure which is formed in decentralization system has been applied since the establishment of La No. 22/1999 (had been amended by Law No. 32/2004) and Law No. 25/1999 (had been amended by Law No. 33/2004). The implementation of decentralization has caused such an expansion of authorities for local government, which is expected to encourage the improvement of local financial capability. Based on fiscal federalism theory, decentralization would make it possible for local government to get in touch more closely to their society, thus they will obtain more information regarding the demand of the society. In that case, they can understand the information related to resources and economical source of the region.

This condition also enables them to allocate resources and other economical sources effectively, reflected in local annual budget and income. By having resources and economical sources allocation, such as an investment in infrastructure and services, they can finally improve social services. Investment in infrastructure and services are expected to generate real economics of the society. Thus, by doing so, they are expected to become a motor for boosting the economy. In essence, their economic growth shapes up a sustainable increase in gross regional domestic products (GDP) (Saragih 2003 and Kuncoro 2007).

Furthermore, with decentralization, the government will support economical growth and fulfill the demand of society. The ability of government for creating welfare reflected in the increasing income can be said as a good government performance. One form of decentralization implementation in financial management is fiscal decentralization. Fiscal decentralization can be defined as the independency of local government in planning, managing and empowering income and expenses which is stated in local government budget (Lindaman and Thurmaier 2002).

In the arrangement of local income and expenses budget, decentralization can be

viewed as the higher the independency level and local government creativity in exploring, improving and managing local potential in budgeting in order to create prosperity. Decentralization of budgeting is based on fiscal federalism theory (Musgrave 1959 and Oates 1993). It is viewed as a system, which emphasizes on the importance of revenue and expenditure assignment.

In fact, so far such an issue above has become a deep concern, due to the increase of people awareness toward accountability and transparency in budget management (Burchell and Listokin 1978). Budget analysis is also an important issue, due the policy of resources allocation in sectors and programs, related to the interests of particular groups involved in the decision making process (Shapiro and Falk 1999).

THEORETICAL FRAMEWORK AND HYPOTHESIS

Budget decentralization based on fiscal federalism theory is expected to be the most proper formula to increase local people welfare through its various multiplier effects. It is because local government is allowed to be close to their people. The closeness of government to people will enable them to explore and acknowledge local need and preferences. Fiscal federalism theory explains that government will tend to be highly wise and endeavor to decide public economical policies which are effective and efficient according to collective preferences of their constituent.

The concept of fiscal federalism also defines that budget decentralization enables local government to acknowledge more the information of preferences and local resources. By having this knowledge, they can empower and allocate the local resources in the form of budget planning for getting their people prosperity. In addition, the local government is said to be much wiser in deciding public economical policies (Oates 1993). According to Blanchard (1993), public economical decision consists of the role of local government in allocation and distribution of

economical sources aimed to create people welfare. Beside, the implementation of budget decentralization will also ease the local government in mobilizing and utilizing local resources to improve public services (Peterson 1994).

Lindaman and Thurmaier (2002) defined that budget decentralization gives positive impact on fulfilling basic needs for people, reflected in the Human Development Index or Indeks Pembangunan Manusia (IPM). The improvement of people's welfare due to the implementation of budget decentralization is usually called as economic efficiency or efficiency (Martinez and McNab 1997). Positive impact of budget decentralization toward performance was also found by Musgrave (1959) and Oates (1993). Their research results showed that local government makes better performance in identifying and fulfilling local people needs, which will affect welfare as the reflection of government performance.

In Indonesia, research about the impact of decentralization toward performance was done by Adi (2005), Khusaini (2005), Bawazier (1988), Ahmad (1990), Hidayat and Damayanti (1992) and Kuncoro (2007). Their research results indicate that budget decentralization gives impacts on local government performance with the increasing of local income and welfare as the indicators.

Hypothesis 1

The higher the budget decentralization, the higher the local government performance.

The impacts of budget decentralization toward economical growth were also defined by Oates (1995), Lin and Liu (2000) which proved positive and significant relation between budget decentralization and economic growth. Budget decentralization will encourage economic efficiency and dynamically support a region's economic growth (Oates, 1993; Martinez and Macnab, 1997). The argument is the region understands its own characteristics so that the expenses aimed for infrastructure and social sector will be effective in promoting economic

growth of a region.

Research by Zhang and Zou (2001) showed that in India, budget decentralization is statistically related positively and significantly to economic growth. Government budget allocation in public expenses of various sectors shows consistent results along with increasing growth. Budget increase is applied to construction projects, non-construction projects, and social services, which decrease center's spending of other sectors so that it increase regional economic growth. Research by Oates (1993), Bird (1993), Bird and Wallich (1993), Bahl and Linn (1992), found that budget and expense decentralization support local economic growth and development from public sector.

In connection with the facts above, Davoodi and Zou (1995) stated that there is positive impact of budget decentralization on economic growth in America. Lin and Liu (2006) also stated that construction spending is a logical conduct done by local government in order to improve public trust to increase economic growth. The research found that there is significant relation between construction spending and decentralization level which will support and accelerate local economic growth. Stine (1994) found that government income should be used more for public service programs. Economic growth is shown by the continuous increase of gross regional domestic product or produk domestik bruto daerah/PDRB (Saragih, 2003 ; Kuncoro, 2007). Indicator of economic growth is the increasing of productivity and per-capita income of the people.

Previous research in Indonesia conducted by Hamzah (2007) found that original local income and general fund allocation have significant impact on economic growth. Research by Darwoto (2007) showed that original local income and general fund allocation affect development expenditures pattern. Adi (2006) defined the relation between local economic growth, development expenditures, and PAD for East Java and Bali, showed that local economic growth has

significant impact toward PAD increasing. Region with positive economic growth has the possibility to increase its PAD. PAD increasing might be obtained by optimizing industrial sector. Result of research in Adi (2007) also defined that PAD might give impacts to economic growth and string impact to fiscal performance. Results of research in Khusaini (2005) stated that budget decentralization has significant and positive impact toward local economic growth.

Hypothesis 2

The higher the budget decentralization level, the higher the economic growth.

The impacts of economic growth toward performance has been defined by Oates (1993) that intuitively, budget decentralization will support economical efficiency especially in public sector which will cause dynamic effect in local economic growth. Public expenses conducted by government particularly in infrastructure providing, will be more effective to be conducted by local government than central government. The capability of local government to provide the more effective infrastructure which is appropriate to the needs and preferences of society reflects good performance of local government.

By applying budget decentralization, local government can mobilize and utilize their local resources to improve public services (Peterson, 1994). Effective mobilization and utilization of local resources would increase local economic growth, which will lead to the improvement of public services. This improvement is the reflection of good government performance. Guess et al. (1997) asserted that authority distribution in fiscal aspect to regional level will be able to make government closer to the people in order to understand more what their local need is. It surely creates more effective and efficient public goods allocation, thus in aggregate it will emerge positive effect toward local economic growth and development. The capability of government in fulfilling local need would reflect a better perform-

ance.

Research result of Adi (2007) also stated that PAD has given significant toward both economic growth and fiscal performance. Khusaini (2005) found that budget decentralization has positive and significant impact toward public sector economic efficiency, local economic growth and people's prosperity.

Hypothesis 3:

The higher the economic growth the higher the local government performance.

Budget decentralization impacts on local government performance was argued by Guess et al. (1997) that budget decentralization gives indirect impact o local government economic growth and development. Authority distribution in fiscal aspect to regional level will be able to make government closer to the people in order to understand more what their local need is. It surely creates more effective and efficient public goods allocation, thus in aggregate it will increase economic efficiency which will emerge positive effect toward economic growth and welfare for sure.

World Bank (1997) also defined that budget decentralization might be able to support economical growth indirectly. The argument is that budget decentralization will increase economic efficiency in government expense sector, thus this dynamic effect will boost economic growth. The increasing of economic growth will indirectly affect government performance.

Hypothesis 4

The higher the budget decentralization level the higher performance the local government will conduct through economical growth.

RESEARCH METHOD

This research uses hypothesis testing design. This design is chosen because it requires empirical testing concerning the impact among budget decentralization variable, economic efficiency variable, and economic growth variable on local government per-

formance based on prosperity. Population covers the whole residence and cities in East Java Province.

The secondary data were obtained from Central Bureau of Statistics. They were panel data consisting cross sections and time series, as the following.

1. APBD Data of residences/cities in East Java from 2004-2007.
2. IPM Data of residences/cities in East Java from 2004-2007.
3. PDRB Data of residences/cities in East Java from 2004-2007.
4. Social Indicator and Macroeconomics Data in East Java from 2004-2007.
5. APBN Data in Indonesia from 2004-2007.

Analysis unit in this research is the local government of residences/cities in East Java.

Concerning the constructs defining the budget decentralization, it refers to the independency of local government in planning, managing and empowering revenue and expenses stated in local government budget (Lindaman and Thurmaier, 2002). This is represented as the following. 1, ratio of total expenditure of each residence/city to total national expenditure (Philips and Woller 1997; Zhang and Zhou, 1998), 2, ratio of total construction expenditure of each residence/city to total national construction expenditure (Philips and Woller 1997; Zhang and Zhou, 1998). 3, ratio of total revenue of each residence/city (APBD), excluding subsidiary of total national revenue (Philips and Woller 1997).

Constraints and definition of economic growth in this research is the increasing of gross domestic product (GDP) or gross national product (GNP) which reflects a state's economic growth. As the indicator of economic growth, it uses the growth of revenue in local area in constant value, the growth level of PDRB or riel gross regional domestic product of the residence/city (Philips and Woller 1997; Zhang and Zhou, 1998).

Local government performance is represented as local government performance as prosperity, in which it is defined and limited as local government success in improving

social service (Lindaman and Thurmaier, 2002). The indicator which reflects social is Human Development Index of *indeks pembangunan manusia* (IPM) including life expectancy index, education index, and income index.

The researcher implemented partial least square (PLS) because PLS can be used to confirm theory and recommend relation among variables in which its theoretical concept and empirical support are weak, without requiring many assumptions, with less number of sample and can be applied in all data scales (Gozali, 2008).

Hypotheses Testing Results

Direct Impact.

Meanwhile the interpretation of hypotheses testing results toward five direct hypotheses proposed in this research can be explained in Table 1. According to Table 1, so the structural equation is:

$$Y_1 = 0.608 X + \varepsilon$$

$$Y_2 = 0.181 X + \varepsilon$$

$$Y_3 = -0.145 X + 0.299 Y_1 + 0.244 Y_2 + \varepsilon$$

Indirect Impact

Analysis of indirect impact among variables in the model is intended to compare the level of indirect impacts of each variable construction. Indirect impact can be seen in Table 2.

DATA ANALYSIS AND DISCUSSION On Local Government Performance

It was found that testing H1 do not support the hypothesis that the higher the decentralization of the budget, the higher the performance of local government. The decentralization level is reflected by the ratio of total budget expenditure of regency/city to total government expenditure, while the local government performance is reflected by the index of education. Judging from the descriptive statistical data, the pattern of influence of budget decentralization on the performance of local government is not significantly negative.

It can be shown by the example of 2004

Tabel 1
Hypotheses Testing Results

H	Impact	Koef Path	T count	Definition
H1 Budget Decentralization (X)	→ Local Government performance (Y3)	-0.145	0.564	Insignificant
H2 Budget Decentralization (X)	→ Economic Growth (Y2)	0.181	2.517*	Significant
H3 Economic Growth (Y2)	→ Local Government performance (Y3)	0.244	2.133*	Significant

* significant at level 5%, value of t table at level 5% = 1.960

Source: Processed Secondary Data.

Tabel 2
Direct-Indirect Impact Testing

H	Exogenous Construction	Effect	Endogenous Construction	Intervening Variabel	Path Indirect Coefficient	Definition
H4	Budget Decentralization (X)	→	Local Government Performance (Y3)	Economic Growth (Y2)	0.044	Significant

Source: Processed Secondary Data.

in Madiun, where the ratio of total expenditure of regency/city to total government expenditure is relatively low at 0.000738 but its influence on the education index is high at 69.03. Blitar also shows the ratio of total expenditure of regency/city to total government expenditure is relatively low at 0.000917 but its influence on the education index is relatively high at 71.20. For Sampang residence where the ratio of total residence/city expenditure to total government expenditure is relatively high as 0.000803 but its influence on the education index is relatively low at 48.47.

On the contrary, the city of Surabaya where the ratio of total expenditure of regency/city to total government expenditure is relatively high at 0.003127, its influence on the education index is relatively high at 85.35. Random pattern of influence of budgets decentralization on the performance of local government can be criticized as one of the weaknesses of the education index determination using weighing system in its calculations.

For Sampang area where most people still do out of formal education which is not

included in the classification of the weighing, then the education index will tend to be lower. For Surabaya where the structure of the population received a lot of migration due to relatively high formal education, the education index tends to be higher.

The results show that the performance is the result of a system, which starts from the process of planning, implementation and results. Budget decentralization as a system will not have any real direct influence on the performance of local government, if its implementation is not supported by economic efficiency and economic growth. This means that the implementation of budget decentralization in its process is not carried out with efficiency and capability of fostering economic growth, it will not result in better performance of local government.

Budget decentralization also has negative effect (-0.145) it has no significant effect on performance of local government. It also reveals that direct budget decentralization which is too high in its level will degrade performance of local government. Based on agency theory it was explained that in the event of authority distribution

with no contract and clear political consensus, will bring up a discretionary power. According to Colombatto (2001), discretionary power would encourage breach of agency contract. The greater the discretionary power of the legislatures, the greater their tendency to put their personal interests. This is due to the needs of executives to achieve their self-interest. As expressed by Elgie and Jones (2000) that the legislatures/executives as principal/agent can also conduct moral hazard in order to achieve their self-interest. Johnson (1994) in his self-interest model also revealed that as the executive agent needs to be re-elected so they will try to maximize its budget, while the constituents wants to maximize their utility. Executives/bureaucrats will try to propose new programs to increase their agency and its constituents' trust to gain benefits from the government.

The research by World Bank (1997) also revealed that the budget decentralization in developing countries, if not offset with good quality of personnel and political accountability, it will create a bad and corrupt government, and poor public services. Moreover if the policy of budget decentralization was taken in haste without any clear political consensus and readiness of the administration, as well as the proper law.

The results of this study is not consistent with the theory of fiscal federalism, which states that the budget decentralization of local government will lead to more information about local needs and resources, as well as further knowledge about the characteristics of each region. The results of this study are not consistent with results of previous studies. The results by Lindaman and Thurmaier (2002), reveals that budget decentralization has positive effect on the fulfilling of basic needs for society (basic needs: better education and a healthier population). Results of the study (Peterson, 1994) also revealed budget decentralization allows local government to be easier to mobilize and use local resources, to improve public services as a measure of government performance.

The study in Indonesia, for example by Adi (2005) revealed that budget decentralization for areas which have reliable natural and human potential will create faster welfare improvement. The results by Khusaini (2005) also revealed that budget decentralization has positive and significant impact on public welfare.

Impact of Budget Decentralization toward Economic Growth

Test results showed H2 hypothesis is not rejected at a significance level of 5%, where the value t count (2.517) is greater than t table (1.960). The results of testing H2 means of empirical data support the hypothesis that the higher the level of budget decentralization, the higher economic growth. The decentralization level is reflected by the ratio of total budget expenditure of residence/city to total government spending, while economic growth is reflected by the ratio of GDP. Descriptive statistics show that the pattern of budget decentralization effect on economic growth is significantly positive. It can be shown by example in 2004 that the ratio of total expenditure Pacitan residence/city to the total expenditure amounting to 0.00071 then the impact to GDP ratio is only 3.94. In Bangkalan ratio of total expenditure of residence/city to the total expenditure amounting to 0.00073 then the impact on GDP ratio is only 4.73. In Lumajang the ratio of total expenditure of residence/city to total government expenditure is higher with the amount of to 0.00795 then the impact on GDP ratio of 5.14 will be higher. Mojokerto residence ratio of total expenditure of residence/city to total government expenditure ratio is relatively high at 0.000882 and the impact on GDP is also relatively high at 5.68. The pattern of significant positive effects can be interpreted that the higher the level of budget decentralization will be able to influence and drive economic growth in residences/cities in East Java.

Empirical evidence from this study revealed that the budget decentralization has

allowed local governments to mobilize and allocate resources effectively, according to local needs. Its logical explanation is the greater authority of local government in formulating and planning resource allocation in the budget revenue and expenditure, will allow local government to obtain information about resources and local needs. This will allow local government to allocate resources effectively, in the form of investment in infrastructure and services. Investment in infrastructure and services will be able to encourage the movement of the real economy, so as to increase revenue. The increase in revenue is expected to increase the community's economic growth.

Indicators of economic growth can be seen in the average growth in gross domestic product (GDP) in East Java from 2004 to 2007 which is relatively high at 5.53% per year, it is the evidence that the budget decentralization for local governments can encourage local economic empowerment. Residences/cities with an average of the highest GDP growth in 2004 – 2007 (Appendices) are Bojonegoro (10.32), Gresik (7.08), Surabaya (6.88), Batu (6.75), Probolinggo (6.28), Tuban (6.19), Malang (6.18), and Pasuruan (6.15), where the dominance of local income is in the industrial sector, trade, hotels and restaurants. The dominance of local area income growth in the agricultural sector is generally relatively low in its PDRB. Areas with the lowest GDP growth including: Sumenep (3.59), Kediri (3.94), Sampang (4.20), Pacitan (4.29), Madiun (4.41), Trenggalek (4.49), Pamekasan (4.66), Ngawi (4.70), Magetan (4.73), and Bangkalan (4.74).

These results are consistent with the theory of fiscal federalism, which states that the application of budget decentralization led local governments will be closer to the people. Local governments will be more aware of information about local needs and resources as well as knowing better the characteristics of each region. Knowledge of this information will lead to the more effective spending on infrastructure and social

sectors to promote economic growth.

These results are also consistent with previous research conducted by Oates (1995), and Lin and Liu (2000) which stated positive and significant relation between budget decentralization and economic growth. Budget decentralization is able to foster economic efficiency and dynamically support economic growth of a region (Oates, 1993), (Martinez and Macnab, 1997). The results of Zhang and Zou (2001) showed that for India, budget decentralization related positively and significantly in statistic with economic growth. Allocation of government budget in public expenses in particular sectors shows consistent results with increasing economic growth. Budget increasing is experienced in construction project, non-construction project and social services, which decrease center's spending in other sectors so that it increase regional economic growth.

The results by Oates (1993), Bird (1993), Bird and Wallich (1993), Bahland Linn (1992), revealed that the revenue and expenditure decentralization can promote growth and economic development of public sectors. Davoodi and Zou (1995) revealed that there are positive effects of budget decentralization to economic growth in America. Lin and Liu (2006) revealed that construction spending is logical efforts made to improve public's trust toward local government to enhance local economic growth.

Impacts of Economic Growth Level toward Local Government Performance

Hypothesis testing results showed that H3 is not rejected at significance level of 5%, where t-count (2.133) is higher than t-table (1.960). Results of H3 testing means there is empirical data supporting the hypothesis that the higher the economic growth the higher the performance of local government. This research results expressed that good economic growth, indicated with PDRB growth (Table 3) in East Java is high which are in 2004 (5.26), 2005 (5.46), 2006 (5.49) and 2007 (5.91) it will be able to improve public

Table 3
GDP and IPM Statistics for Residences/Cities in Jawa Timur 2004-2007

Year	2004	2005	2006	2007	Means
GDP	5.26	5.46	5.49	5.91	5.53
IPM	65.82	66.35	66.00	66.85	66.25

Source: Processed Secondary Data.

services.

The indicator of public services improvement could be seen in IPM index which experiences increasing from 2004-2007 from 65.82 to 66.85. This IPM index is defined by education index of 73.23, life expectancy index of 70.17 and revenue index 55.57. The logical explanation is that the higher economic growth will be able to drive local economic mobilization. This local economic mobilization will allow local government to improve social services. The improvement of social services might be seen in the increasing of education index, life expectancy index, and revenue index.

These results are consistent with the theory of fiscal federalism, which reveals that the budget decentralization of local government will lead to more information about local needs and resources as well as better knowledge regarding the characteristics of each region. This knowledge will allow local government to mobilize and allocate resources more effectively so as to encourage economic growth in an effort to meet local needs.

These results are consistent with results of previous studies. Oates (1993) revealed that budget decentralization encourage economic efficiency, especially in public sector, which will cause dynamic effects on regional economic growth. Public expenditure especially the provision of infrastructure will be more effectively done by local government (sub-national government) rather than by central government. Local government ability to provide the more effective infrastructure will reflect the good performance of local government. Results of research conducted by Peterson (1994) also revealed that budget decentralization will allow local

government to be easier in allocating and mobilizing resources to improve local public services. The study Guess et al. (1997), expressed that authority distribution in fiscal aspect will bring government closer to local people that will allow better understanding on local need. This makes the allocation of public goods more effective and efficient, so aggregately it would cause positive effect on growth and regional economic development. The ability of local governments in meeting need reflects better performance.

On Local Government Performance through Economic Growth

Hypothesis testing results showed that H4 is not rejected at significance level of 5%. Budget decentralization (X) influences local government performance (Y3) through economic growth (Y2) it is shown in table 1, where significant impact of budget decentralization (X) toward economic growth (Y2) (t count = 2.517) and impact of economic growth (Y2) toward local government performance (Y3) is also significant (t count = 2.133).

The above finding means that the budget decentralization might be able to drive economic growth, and finally it will be able to mobilize real economics in East Java. The indicator of the ability of local government to improve welfare is reflected in the increasing of social services. It can be explained that if the government is able to allocate budget to be invested on infrastructure and facilities, the visible impact is the more dynamic real economic among the people. For instance the construction of street, water, and water electricity will be able to foster local people economic growth either in agricultural, livestock, and trade sectors. The

growth of real economic will support increasing of people's income. At macro level, this increasing in people income will be able to support economical growth in East Java.

These results are consistent with the theory of fiscal federalism, which reveals that the budget decentralization of local government will lead to more information about local needs and resources as well as better knowledge regarding the characteristics of each region. This knowledge will allow local government to mobilize and allocate resources more efficiently so that it will foster economic growth and indirectly increase government performance.

These results are consistent with results of previous studies. Guess et al. (1997) revealed that budget decentralization indirectly affects local economic growth and development. Authority distribution local government in fiscal sector will allow government to be closer to local people and understand the local needs better. It makes the more effective and efficient allocation of public goods. In aggregate it will increase economic efficiency and emerge positive effects to the growth which will of course give impact to the welfare. According to World Bank (1997) budget decentralization stimulates economic growth indirectly. The argument is that budget decentralization would increase economic efficiency in the sector of government spending, so this dynamic effect will drive economic growth. Increased economic growth will indirectly affect the performance of government.

CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

First, if the implementation of budget decentralization could not boost economic growth then it would not be able to affect local government performance. Second, budget decentralization of residences/cities in East Java could support local government to mobilize and allocate resources effectively, appropriate with local need, thus it can increase economic growth. Third, economic growth in residences/cities in East Java al-

lows the local government to increase more the quality of public services. Fourth, budget decentralization in residences/cities in East Java give significant impact on local government performance through economic growth. It means that the higher the budget decentralization, when it is able to boost economic growth, then it will be able to increase local government performance.

Yet, this study embeds some limitations. First, this research didn't do matching with the research sample so that the researcher could not decrease the possibility of sample variance. Second, many other variables were not discussed here might be affecting local government performance. Measurement of other variable, from budget decentralization variable, economic growth, and local government performance might have different impacts.

Third, research scope is only in the residences/cities in East Java. The application of this research model in different scope might affect research results. Fourth, performance based on human development is still not appropriate enough to explain indicators regarding officers' professionalism that might affect local government performance.

Finally, this research did not discuss the value system, working manner, and working behavior which are needed to support decentralization system/method.

First, future research needs to do matching and categorization toward research sample so that the impact of sample variance could be neutralized. Second, future research is expected to conduct research with similar topic and model, with larger and developed variable and research measurement. Third, future research should consider the application of research concept/model with different research scope.

Fourth, future researcher should add other indicators which might reflect learning process of government officers which will form professionalism of government officers themselves. Finally, future research should be able to observe deeper regarding the perspectives, working culture, and officers be-

havior, because the way of thinking and behavior of government officers are the key factors toward success in decentralization implementation.

Theoretically, decentralization would be possible to increase local government performance when it is able to boost local economic growth in accordance to local need information. Practically, the government needs to consider the diverse human resources, natural resources, original local revenue, and information support of local resources in implementing decentralization. Besides that, the local government performance should be assessed not only from its final result, but also overall performance. The application of good governance should be preceded by the existence of financial planning, in the form of Budget of Local Revenue and Expenses. Budget of Local Revenue and Expenses is a working contract made between local government as the agent and toward the local representative or principal as constituents' representatives.

Politically, the government needs to conduct coordination related to regulation policies, either between central and provincial, or between provincial and residential/municipal. They also have to consider values, culture, and perspectives as well as behavior of officers required to form decentralization system in designing stage. Inappropriate decentralization design with values, culture, perspective and behavior of officers would not help to allow good government performance. Third, local government needs to do conduct education and training toward government officers in order to improve their skills/ability and professionalism. In order to change behavior and working culture of government officers from centralization system to decentralization system needs continuous and sustainable learning process.

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APPENDICES**GDP Total Average of Regency/City in East Java 2004-2007**

Regency/City	GDP Total Average
BOJONEGORO	10.32
GRESIK	7.08
SURABAYA	6.88
BATU	6.75
PROBOLINGGO	6.28
TUBAN	6.19
MALANG	6.18
PASURUAN	6.15
SIDOARJO	6.07
PASURUAN	6.04
BLITAR	6.04
MOJOKERTO	5.98
NGANJUK	5.81
MOJOKERTO	5.80
JOMBANG	5.65
TULUNGAGUNG	5.63
MADIUN	5.63
MALANG	5.52
LAMONGAN	5.52
JEMBER	5.49
BONDOWOSO	5.37
BANYUWANGI	5.33
SITUBONDO	5.33
PROBOLINGGO	5.28
BLITAR	5.22
LUMAJANG	5.13
PONOROGO	4.95
KEDIRI	4.88
BANGKALAN	4.74
MAGETAN	4.73
NGAWI	4.70
PAMEKASAN	4.66
TRENGGALEK	4.49
MADIUN	4.41
PACITAN	4.29
SAMPANG	4.20
KEDIRI	3.94
SUMENEP	3.59

Source: Processed Secondary Data.