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TRANSFER FUND, REGIONAL EXPENDITURE, POVERTY, AND INCOME INEQUALITY: EVIDENCE FROM BANTEN PROVINCE

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ABSTRACT

Transfer fund from central to local government have been allocated since 2001 and annually increase significantly. However, the decreasing level of poverty rates and income inequality in the region over the last decade tends to deliberate. Various researches which have been conducted only measuring direct effect of transfer funds to poverty and income inequality and ignoring transmission of transfer fund through regional expenditure and public service. The purposes of study are to analyze regional expenditure pattern and to estimate direct and indirect impact of transfer fund on poverty and income inequality through regional expenditure and public services in Banten Province. The descriptive analysis and dynamic simultaneous equation models using data panel for 2010-2015 was employed in this study. Econometric model is constructed by 4 equation blocks, consisting of regional income, regional spending, public services, and poverty and income inequality. The results indicate that the dependence of local governments on transfer funds is still high at 64.69%, with the average of personnel budget allocation is 50.01%. The largest personnel expenditure is allocated by Pandeglang Regency at 65.29% while the smallest personnel expenditure is allocated by South Tangerang City at 35.44%. The second largest expenditure allocation is the capital expenditure allocation with the average of 25.05%. Meanwhile, the average allocation of goods and services, and administrative expenditures are 23.67% and 21.64%, respectively. The result also shows that general allocation funds significantly affect the increase of personnel expenditure, capital, goods and services, as well as grants and social aid. In addition, specific allocation funds only affect the increase of capital and education expenditures, while revenue sharing funds show a positive effect on personnel expenditure. Local generated revenue (pendapatan asli daerah/PAD) has positive effect on capital expenditure, personnel, and goods and services. Furthermore, transfer funds through health, education, and public works expenditures tend to significantly reduce poverty, but cannot be able to reduce income inequality yet.

Keywords: Regional income, regional expenditure, public services, dynamic simultaneous model

BACKGROUND

The policy of central to regional transfer funds is one form of fiscal policies. According to Musgrave and Musgrave (1989), fiscal policy has three main functions: allocation, distribution, and stabilization. Referring to Law no. 33 Year 2004 on Fiscal Balance between Central and Regional Governments, the objective of balancing funds is to

foster fiscal performance and regional development, such as regional financial self-sufficiency, poverty reduction, and income distribution.

Transfer funds to the regions and villages continue to increase. During the period of 2010-2016, it is recorded that transfer funds increased by an average of 19.99% per year, while the poverty rate slowed down by 0.42% per year, and income inequality decreased by 0.003 points per year. Such phenomenon also occurred in Banten Province, where transfer funds in the same period increased by an average of 39.49% per year, while the poverty rate decreased by 0.26% per year, and income inequality dropped by 0.005 points per year.

Studies on the impact of fiscal decentralization have been widely performed, as by Khan *et al.* (2015), who found that public expenditures tend to increase an income inequality, while public sector investments tend to lessen it. According to Shen (2012); Goerl and Seiferling (2014), there is a trade-off trend between fiscal policy and income. Meanwhile, Gallo and Sagales (2012) conclude that the distributions of expenditures and direct taxes significantly reduce income inequality. Another study, conducted by Jutting *et al.* (2004); Steiner (2005); and Lisna *et al.* (2013), found that transfer funds can reduce poverty. In contrast, the results of studies conducted by Kuncoro (2004); Kusumadewi and Rahman (2007); and Murniasih and Mulyadi (2011) instead found the flypaper effect phenomenon.

So far, studies that were performed put forward more on the impact of fiscal decentralization funds on macroeconomic indicators, ignoring the transmission through regional spending and services. According to Suzetta (2008) and Yustika (2013), the easiest parameter to assess the success of decentralization is by checking the extent to which the quality of public services is provided and the accountability of local governments. The abovementioned facts signify that it is necessary to examine the impact of transfer funds on the income inequality and poverty through the behavior of regional spending and public services.

METHODS

This study was conducted in Banten Province using secondary data from 2010-2015. The data that were sourced from BPS and Directorate General of Fiscal Balance were in the form of panel data from eight regencies/cities in Banten Province. The secondary data consists of General Allocation Funds (DAU), Revenue Sharing Funds (DBH), Specific Allocation Funds (DAK), Locally-Generated Revenue (PAD) and its components, and other Transfers. Regional Expenditures consist of capital expenditures, personnel expenditures, and the expenditures on goods and services, subsidized items, and grants. Expenditures by function are those spent on educational affairs, health purposes, and public works. Development performance is assessed using poverty and income inequality, which refers to one of the objectives of data transfer that is to reduce the gaps in income and poverty. Poverty data provides the percentage of impoverished people, whereas data on income inequality per regency is measured using the Gini index.

The data is processed using simultaneous equation model which is constructed to four blocks, namely; regional revenue block, regional expenditure block, public service block (health, education, public works), and income inequality & poverty block. Furthermore, these four blocks consist of 23 structural equations and 3 identity equations. Regional revenue block is reflecting the revenues obtained from transfer funds, PAD, and other types of transfers. The behavior of regional income will affect the expenditures made by said regions; such expenditures, either directly or indirectly through public services, will have an

impact on the income inequality and poverty. The simultaneous equation model is projected using Two-Stage Least Square (2SLS) which is processed using Eviews9 software.

RESULTS AND DISCUSSIONS

Figure 1 illustrates the regional revenues of the regencies/cities in Banten Province, which in general indicates an increasing trend. In 2010, regional revenue of Banten Province was recorded to be Rp 2,377.32 millions, and then went up to Rp 7,644.63 millions in 2015. Tangerang is recorded to be the regency with the highest regional revenue compared to other similar regions. Its revenue has doubled in 2015 from Rp 2,191.93 millions in 2010. On the contrary, Serang is the city with the lowest regional revenue recorded.
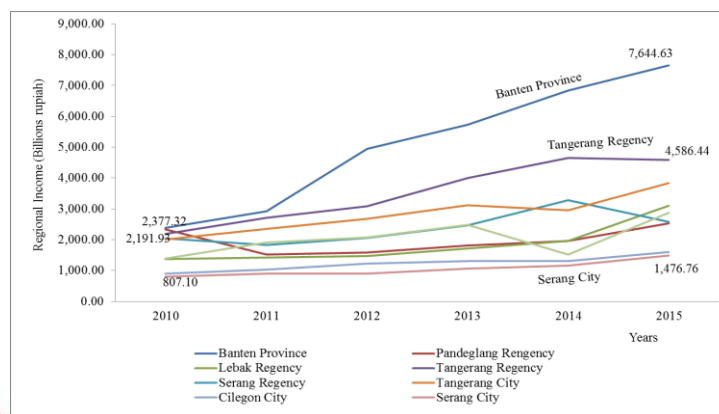

Figure 1 Regional Income in Banten Province 2010-2015

Figure 2.a provides an illustration on how the role of regional financial transfer funds in the regional revenue during the period of 2010-2015 was still relatively vital, which contributed 64.69% on average. The analysis result points out that in general, the cities of Banten Province have lower fiscal dependency compared to its regencies; except for Serang City, which still has an average of 72.60% fiscal dependency. South Tangerang City and Tangerang City, playing the role as the buffer cities for the nation's capital, have fiscal dependency of 52.45% and 54.27% respectively. The high rate of dependency in a number of regencies/cities indicates the low rate of their regional fiscal self-sufficiency, which results in the high level of financial risks (Sukanto dan Mukhlis 2013).
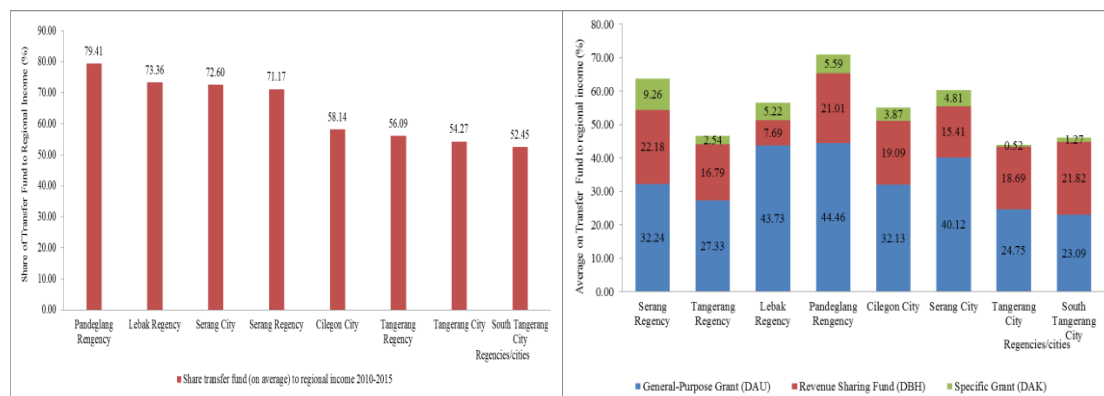
(a)   (b)

Figure 2(a) Average share of transfer funds on the regional revenue in Banten Province during 2010-2015,
(b) Contributions made by DAU, DAK, and DBH to regional revenue in Banten Province during 2010-2015

Transfer funds in the form of balance funds consisting of DAU, DBH, and DAK are still the main sources of regional revenue for regencies/cities in Banten Province. The highest proportion of regional revenue in each regency/city still comes from DAU, with DBH comes second. The largest contribution of DAU to regional revenues, which is 44.46%, is recorded by Pandeglang Regency, followed by Lebak Regency, which is 43.73%. At the same time, the smallest DAU contribution to regional revenue is recorded in South Tangerang City, at 23.09% (Figure 2b). The high number of DAU contribution to regional revenues that is still recorded in several regions serves as an indication of their low financial capacity.

Vasquez and Yao (2009) argue that it is undeniable that fiscal decentralization increases the number of workers in public sectors. This is also implicitly occurring in the regencies/cities of Banten Province, where the phenomenon of regional expansion has an impact on the increasing number of local government personnel. As a result, more money needs to be allocated for personnel expenditure. The pattern of regional spending in all regencies/cities is dominated by personnel expenditure, with the allocation averaging on 50.01% over the period 2010-2015. The largest personnel expenditure allocation was recorded by Pandeglang Regency (65.29%), Lebak Regency (54.25%), Serang Regency (54.15%), and Serang City (55.12%). Furthermore, the percentage of personnel expenditure allocation in several other regions is as follows; Tangerang Regency (38.71%), Tangerang City (48.59%), Cilegon City (48.51%), and South Tangerang City (35.44%)(Figure 3). The study conducted by Liddo *et al.* (2015) found that a less than 30% public expenditure rate gives positive effect to the economic activities. The results of the study seem to confirm as to why public spending of the regencies/cities in Banten Province has no positive effects on economic activity. The data shows that the allocation for personnel expenditure is still more than 30%, while the average allocations for expenditure of goods and services and for administration are 23.67% and 21.64% respectively.
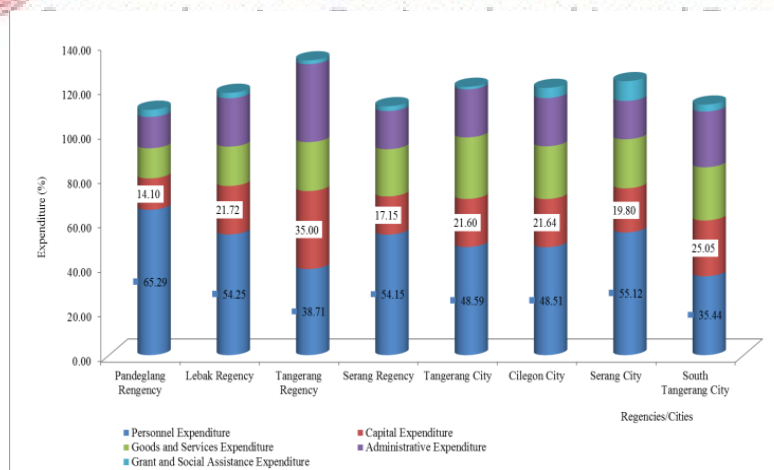

Figure 3 Composition of Regional Spending in Banten Province

Capital expenditures such as infrastructure development for roads for farming, retention basins, and irrigation canals are believed to be able to improve regional development performance (Rahmadi and Safri 2014). The analysis shows that the average share of capital expenditure of the regencies/cities in Banten Province is 22.01%, still below the expectation from the central government, which requires that at least 25% allocation goes to capital expenditure (Budiarso 2016).

The Impact of Transfer Funds on Regional Expenditure

In general, the estimation results show the model meets both the economic criteria (theoretically meaningful) and the statistical criteria (goodness of fit). Transfer funds to the regions affect the behavior of regional spending. DAU and PAD variables give positive influences to capital expenditures, personnel expenditures, goods and services expenditures, educational affairs expenditures, health expenditures, and public works expenditures.

Table 1 Estimated Transfer Fund to Local Expenditures

Independent Variables	Good and Services Expenditures	Capital Expenditures	Personnel Expenditures	Grant and Social Aid Expenditures	Education Expenditures	Public Works Expenditures	Health Expenditures
				Dependent Variables			
Contansta	0.07	-12.621***	1.001	12.834**	-43.736	-43.091	-30.398
General Allocation Fund (DAU)	0.460***	0.830***	0.683***	1.048***	7.329***	6.832***	6.960***
Specific Allocation Fund (DAK)	0.001	-0.01	0		-0.032	-0.017	0.054
Revenue Sharing Fund (DBH)	-0.072	-0.018	0.024	0.142	-0.628	-0.71	-0.584
Locally-Generated Revenue	0.349***	0.457***	0.033	0.086	3.490**	3.432**	3.770**
Province and Vilage Fund	-0.2285	-0.0956	-0.0470	0.9673	5.6212	4.7445	5.9356
Civil Servants (PNS)	-0.1826		0.114*	-1.617***	-1.186	-0.672	-1.922
Other Transfers	0.526**	0.27	0.239**	-1.232*	-13.532**	-12.210**	-14.066**
Lag Good and Services Expenditures	0.008						
Lag Capital Expenditures		0.042***					
Lag Personnel Expenditures			0.0001				
Lag Grant and Social Aid Expenditures				-0.026			
Lag Education Expenditures					0.867***		
Lag Public Works Expenditures						0.892***	
Lag Health Expenditures							0.887***
Adj. R-squared	**0.913**	**0.801**	**0.955**	**0.222**	**0.708**	**0.73**	**0.735**
Durbin Watson	**1.569**	**2.449**	**0.866**	**1.806**	**2.189**	**2.208**	**2.143**

Table 1 provides information on the results of structural equation regression showing that goods and services expenditures are significantly affected by DAU, PAD, and other legitimate incomes. The DAU parameter coefficient of 0.4603 means that every 10% increase in DAU will increase the spending on goods and services for as much as 4.6%. The allocation for goods and services spending in the APBD (Regional Budgets) of each regency/city in Banten Province is 21.46% on average, relatively similar to that for capital expenditure. PAD has significant effect on goods and services spending in regencies/cities, where the PAD coefficient of 0.3488 means that the increase in PAD will encourage the increase of goods and services spending (Table 19). For some regions, such as South Tangerang City, Tangerang City, Cilegon City, and Tangerang Regency, PAD has contributed more than 20% to local revenue. The increase in PAD encourages regional expenditures, including goods and services spending. Whereas DAK, DBH, other joint funds (provincial transfers, village funds), and the number of civil servants have no effect on the goods and services expenditure.

The analysis results also show that capital expenditures are affected by DAU, PAD, and capital expenditure from the previous year. At the same time, DAU has a positive effect on capital expenditure with a coefficient of 0.8302, which means that every 10% increase in DAU, there is an 8.3% increase in capital expenditure. In addition, positive effect on capital expenditure is also seen in PAD, with the parameter coefficient of 0.4569; whereas DAK, DBH, provincial transfers and village funds, and other regional revenues have no significant effect on capital expenditures.

Personnel expenditure is a component in both direct spending and indirect spending. In indirect spending, personnel expenditure is used for payment of salaries, honorarium, and allowance; while in direct spending said component is used in the payment for non civil servants. Regression results show that personnel expenditure is influenced by DAU, civil servants, and other regional income. The DAU coefficient is 0.6829, meaning that every 10% increase in DAU will increase personnel expenditure by 6.82%. This is because the civil servant indicator in the DAU formulation is used as the basic allocation component in determining the amount of DAU to be received by the region.

The result of the research shows that DAU significantly gives positive impact to the spending for grants and social assistance, with variable coefficient of 10.48, which means that every 1% increase in DAU has the potential to increase the funds for grants and social assistance by 10.48%. In addition, the results of the analysis in the previous section show the huge contribution of DAU to regional revenues, meaning that the dependence on DAU as a source of financing is very high. On the other hand, the number of civil servants and the other income have negatively affected the spending for grants and social assistance. The analysis shows that the configuration of the expenditures for grants and social assistance in districts/cities during the period of 2010-2015 was 3.41% on average, with Serang City being the region with the largest allocation (8.88%).

Regression results indicate that the factors significantly influencing the spending for educational affairs are DAU and PAD, each with coefficients of 73.29 and 34.90 respectively. While DAK, DBH, Funds transfer and village funds (other combined funds), civil servants, and other regional income have no noteworthy effect. It can be explained that the allocation of spending for educational affairs has been stipulated in the 1945 Constitution article 31, paragraph 4 which reads "the state prioritizes education budget at least twenty percent of the state budget revenue and expenditure, as well as from the budget of regional income and expenditure to meet the needs of the implementation of national education". The provisions of this legislation require that the government provides a 20% expenditure allocation from the pure APBD (Regional Budgets). One implication of this provision is the priority arrangements in regional budgets, where the prepared program is sometimes only a copy of the previous year without any regards to the urgency of a program, as long as it meets the required 20% allocation for educational budget.

Health spending should refer to the provisions of Law Number 36 Year 2009 on Health, especially article 171 paragraph (1) which reads "the amount of health budget allocated by the government is at least 5% of the state budget (*APBN*), excluding payroll". Moreover, in paragraph (2) it is stated that the health budget of the provincial, regency/city government is allocated at least 10% of the regional budget (*APBD*), excluding payroll. Based on the provisions of said legislation, the amount of health care spending depends on the amount of APBD. Regression results point out that the factors affecting health care spending are DAU, PAD, and the spending in the previous year. In addition, DAU and PAD are the largest components in the APBD structure, thus the increase in these two variables will lead to an increase in the health budget. Studies also show that the amount of expenditures for Public Works affairs is positively and significantly influenced by DAU, PAD, and the spending in the previous year. The coefficient of DAU is 69.60%, meaning that a 1% increase in DAU will also increase public works expenditure by 69.60%. Meanwhile DAK, DBH, provincial government transfer funds and village funds (other joint funds), civil servants, and other regional revenues have no significant effect.

The Impact of Transfer Funds on Inequality of Income and Poverty

A study by Lisna *et al.* (2013) found that an increase in the fiscal capacity of local taxes and profit-sharing taxes have the greatest impact in reducing poverty, especially in agricultural households. This study also shows that the increase in General Allocation Fund (DAU) has a negative impact on agricultural poverty. According to Jutting *et al.* (2004), the impact of decentralization on poverty depends on the physical condition of a country, such as the availability of infrastructure, capacity, and the willingness of public officials to conduct pro-poor programs.

Inequality among classes of income becomes the focus of the current government, where increases in inequality indicate an increasingly widening inequality among said classes. Fiscal policy and educational improvement are the important factors in reducing inequality (Norris *et al.* 2015). The study found that the poverty rate and income inequality in the previous year had a negative effect on current income inequality. The coefficient of poverty is -0.0067, which means the poorer a person is, the higher the inequality will be .

Table 2 Estimated Transfer Fund to Income Inequality and poverty

Variable	Gini Ratio	Poverty
Constanta	0.3007	-7.5484
Log Health Expenditure	0.0077	
Log Education Expenditure	-0.0015	
Log Public Works Expenditure	-0.0061	
Regional Dummy	0.0192	
Poverty Rate	-0.0067**	
Log Net Enrollment Rate of Senior High School (APMSMA)	-0.0117	
Log Grant and Social Assistance	-0.0018	-0.0178
Log GDRBCapita	0.0004	-0.3329**
Sanitation		0.0407**
Drinking Water		-0.0647***
Imunitation		0.0011
Log Capital Expenditure		-0.2579**
Log Average School Life Expectancy		-1.5930
Consumers Price Index		0.0481**
Construction Cost Index		-0.0492
Unemploment		0.0436
Lag Gini Ratio	0.3478**	
Lag Poverty		0.9462**
Adj. R-squared	**0.6446**	**0.9398**
Durbin Watson	**2.0863**	**2.4470**

*** indicates α < 0.01

** indicates α < 0.05

Expenditures on educational affairs and public works have contributed to a decrease in income inequality, indicating that regional spending in education has the potential to reduce such inequality. Improving the level of education will also improve the quality of human resources (Sylwester 2000), so much so that it can also break the chain of poverty. Improving access to lagging and outlying regions through public work expenditures tends to

lower the income inequality (Harun *et al.* 2012). In addition, grants and social assistance focusing on those who are really in need will also tend to lower the level of inequality. Another finding is that there is a positive relationship between per capita GRDP with inequality, indicating that per capita GRDP is not inclusive.

Poverty is a multidimensional problem, in the sense that many factors influence and relate to one another. According to Sagir (2009), the poor are trapped in a cycle of poverty, and one way to break the poverty chain is to improve the quality of education (Zhang 2014). Education and health expenditures play an indirect role in influencing poverty alleviation (Widodo *et al.* 2011). Studies conducted by Aquilar *et al.* (2017) has stated that education and health spending will help bring down the inequality and poverty. The results of this study also found that drinking water, capital expenditure, and per capita GRDP have negative effects on poverty. This drinking water has a coefficient of -0.0647, meaning that at every 10% supply of drinking water, there is a 0.6% decrease in poverty. Additionally, capital expenditure has a coefficient of -0.2579, which can be interpreted as every 10% increase in capital expenditure tends to reduce the poverty rate by 2.5%. The results of this study also show that per capita GRDP tends to decrease the poverty levels, so efforts are needed to increase per capita income. Pro-poor policies that can expand public access are urgently needed (Montiel 2014), which can be done through empowerment and incentives for MSEs, thereby increasing community revenues.

The consumer price index has a positive and significant effect on poverty. An increase in this consumer price index will lead to a hike in poverty rate. Such CPI increase will also greatly affect households in the third and fourth deciles (almost poor and vulnerable poor). Everytime there's a price increase, there will be a decrease of purchasing power in the community, which consequently brings down the status of the households in those deciles into the category of poor households. Therefore, it is necessary for the government to maintain price stability, so that the almost poor and vulnerable poor households do not fall into the category of poor households. In the mean time, the unemployment rate is positively related to poverty, where every increase in the unemployment rate will most likely mean an increase in the poverty rate.

Table 3 Pro-poor Budget in Banten Province for the Year of 2014-2016

Year	APBD (in billion Rupiah)	Pro Poor Budget (in billion Rupiah)	Ratio of Pro-Poor Budget to APBD (%)	Poverty rate (%)
2014	7,870	601.85	7.65	5.51
2015	9,150	893.53	9.76	5.75
2016	8,810	948.25	10.76	5.42

Source: TKPK of Banten Province, 2018

Table 3 provides an illustration that the pro-poor policies are reflected in APBD fund allocations that are in favor of the poor. The analysis shows that the APBD (Regional Budgets) of Banten Province, which was Rp 7,870 billion in 2014, has increased to Rp 8,810 billion in 2016. Additionally, the pro-poor budget in the same period has also increased from Rp 601.85 billion to Rp 948.25 billion. The percentage of pro-poor expenditure to the Provincial Budget of Banten has increased significantly, from 7.64% in 2014 to 10.76% in 2016. The increase in the pro-poor budget has been linearly reducing the poverty rate, since it was noted that in the same period the poverty rate has decreased by 0.09%.

CONCLUSION

Transfer funds to the regions are still the main source of revenue for regencies/cities in Banten Province, which unfortunately still cannot be matched by the increase of locally-generated revenue, thus causing the low level of regional financial independence. The Regional Budgets of regencies/cities during the period 2010-2015 have been largely allocated to personnel expenditures, goods and services spending, and grant and subsidy spending, as a result pro-poor budgetary allocations are still relatively small compared to other budget allocations. Transfer Funds through education expenditures were able to increase the net enrollment rate at various levels of education, while public works expenditures proved to improve services in the field of sanitation and drinking water supply. Expenditures on educational affairs, health, and public works proved to still be incapable of reducing income inequality. Increases in capital expenditure and drinking water tend to decrease poverty.

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