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The Influence of Domestic Budget Distribution Policy and Fiscal Policy on The Sustainability of Economic Growth

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Abstrak

Tujuan dari penelitian ini adalah untuk menganalisis dampak dari distribusi anggaran daerah dan kebijakan fiskal terhadap pertumbuhan ekonomi daerah. Penelitian ini menggunakan analisis data panel untuk menguji dan menganalisis dampak dari distribusi anggaran dan kebijakan fiskal terhadap perilaku belanja daerah yang berdampak terhadap pertumbuhan perekonomian daerah. Hasil dari penelitian menunjukkan bahwa semakin besar nominal transfer dana yang dilakukan pemerintah daerah akan semakin meningkatkan belanja publik. Hasil lain dari penelitian menunjukkan bahwa perilaku birokrasi di pemerintahan daerah cenderung berupaya meningkatkan anggaran dan proyek publik daripada memenuhi kebutuhan masyarakat dan program kerja secara efektif dan efisien. Kebijakan fiskal akan terpengaruh bila terjadi penurunan belanja daerah sebagai dampak dari jumlah distribusi anggaran yang juga menurun.

Kata Kunci: *Anggaran Daerah, Perekonomian Daerah, Kebijakan Fiskal*

Abstract

The purpose of this study is to analyze the impact of regional budget distribution and fiscal policy on regional economic growth. This study uses panel data analysis to test and analyze the impact of budget distribution and fiscal policy on regional spending behavior that has an impact on regional economic growth. The results of the study indicate that the greater the nominal transfer of funds made by the regional government, the greater the increase in public spending. Other results of the study indicate that bureaucratic behavior in regional governments tends to seek to increase the budget and public projects rather than meet the needs of the community and work programs effectively and efficiently. Fiscal policy will be affected if there is a decrease in regional spending as an impact of the amount of budget distribution which also decreases.

Keyword: *Regional Budget, Regional Economy, Fiscal Policy*

INTRODUCTION

Fund transfers from the central government to the regions are an important topic in the economic literature, especially in the context of fiscal decentralization and resource distribution (Abidin et al., 2023). There are several main reasons why these fund transfers are justified, as are frequently outlined in various economic studies (Tannady & Sitorus, 2017). Fund transfers can help to promote equitable development and reduce regional disparities. Fund transfers increase efficiency in resource management by allowing regions to carry out government functions that may be more efficient at the local level, such as the provision of health services, education, and infrastructure (Putra et al., 2020). Fund transfers from the center also serve to compensate for fiscal imbalances that may occur due to differences in revenue potential between regions. This allows regions with limited tax bases or inadequate natural resources to provide public services similar to those of wealthier regions. In addition, fund transfers also serve as a macroeconomic stabilization tool. In situations where regions experience economic decline, fund transfers can help stabilize the region's economy and prevent negative impacts on the national economy (Asmara et al., 2023). Overall, the economic literature supports fund transfers from the central government to the regions as an effective way to ensure social justice, economic efficiency, and national stability (Hertina et al., 2023).

Limited management capacity at the local government level is often the cause of overspending. Many local governments do not have sufficient administrative capacity or expertise to manage large amounts of funds efficiently (Putra et al., 2024). When transfers increase, they may be tempted to spend the money quickly without careful planning,

resulting in overspending or unsustainable projects (Putra et al., 2020). In addition, with increased funding, focus tends to shift to short-term projects that provide instant results without considering long-term impacts (Sutrismi et al., 2024). Budget dynamics and substitution effects also play a role in this phenomenon. Rather than using transfers to replace or supplement local revenues, local governments may choose to increase spending overall (Putra, 2019). This means that transfers not only replace existing spending, but also expand the total budget, resulting in overspending (Dewi et al., 2020). Furthermore, because transfers often come with strings attached, local governments may not always allocate funds to areas of greatest need but instead to projects that are easier to implement or that appear more politically advantageous (Dharmawan et al., 2024). Overall, the flypaper effect phenomenon underscores the significance of designing and overseeing transfer policies effectively to guarantee the optimal use of public funds for community welfare (Alfiah et al., 2023).

Numerous theoretical studies explain why an increase in central government transfers often impacts local government spending more than it does local community income (Fillaili et al., 2011). In this regard, one of the main concepts is fiscal illusion, which states that voters are often not fully aware of the sources and uses of public funds, especially if the funds come from central transfers (Bakri, 2015). This condition reduces voters' attention to increases in spending funded by transfers, allowing local governments to increase spending without significant resistance (Jamaluddin, 2018). Another relevant concept is the bureaucracy model, which explains the flypaper effect phenomenon. In this model, local bureaucrats or politicians focus on maximizing the budget they manage, so they tend to prioritize spending over efficiency. This phenomenon demonstrates that local communities often prioritize budget expenditures over those allocated from the center. Strong oversight and accountability mechanisms are crucial to address this issue, ensuring the efficient use of transfer funds in the community's interests and preventing unproductive spending.

METHOD

This study uses panel data analysis which compares the fixed effect model and the random effect model, to determine the most appropriate model. The results of the test indicate that in all cases tested, the fixed effect model is more appropriate for estimation. The fixed effect model is better able to capture unobserved and region-specific variations, making it more suitable for handling panel data in this context. By using the fixed effect

model, the analysis can be more accurate in describing how government transfers affect regional spending, considering that this model controls for individual fixed effects that may affect expenditure. Furthermore, to test the asymmetry hypothesis, the analysis focuses on the coefficients obtained from the fixed effect model. This test aims to determine whether the spending response to government transfers is symmetrical or asymmetrical. We can identify significant differences in the effect of government transfers on regional spending based on certain contexts or conditions by analyzing the coefficients, which can reflect different spending patterns in response to changes in transfer funds.

RESULT AND DISCUSSION

The finding suggests that increasing transfers from the central government to local governments has a greater impact on public spending than increasing local revenues. In this context, the flypaper effect explains that local governments tend to spend transfer funds more than those derived from direct local revenues. The analysis using a fixed effect model has successfully identified this pattern by taking into account variability specific to each region and controlling for individual effects that may affect spending. This finding confirms that local governments are more likely to use transfer funds to expand public spending than to rely on increasing local revenues. The perception of transfer funds as free money and the absence of efficiency incentives may lead to higher spending than local communities actually need or desire. This finding is important for designing fiscal policies and monitoring fund allocations.

The results of the analysis show that the behavior of bureaucracy at the city government level is different from the assumptions of traditional models based on benevolent governance. These findings indicate that when faced with increased transfers from the central government, municipalities tend to provide more public goods than predicted by traditional models that assume utility maximization based on median voter preferences. Bureaucrats appear to be more focused on maximizing their own budgets, opting to spend more transfers, and perhaps not in accordance with the optimal needs of local communities. This behavior suggests that bureaucrats may use transfers to expand the budgets and public projects they control rather than to efficiently meet community needs and preferences. These findings highlight the need for strict monitoring and accountability mechanisms to ensure that transfer allocations are in line with public needs and not simply to maximize bureaucratic budgets.

The results show that the relevant coefficients do not exceed one in all the cases analyzed. The panel data methodology, which allows analysis based on data from municipalities over a period of time, provides a more in-depth view of local dynamics and developments compared to cross-sectional estimation. In contrast, the panel data methodology offers the advantage of integrating richer information on changes occurring in each municipality. Thus, this approach allows for a more accurate and detailed assessment of how effects and other phenomena develop and affect local government spending over time. In conclusion, these findings indicate that panel data methodology provides a more comprehensive perspective than cross-sectional approaches in analyzing local government spending dynamics and related effects. This reinforces the importance of using appropriate methodologies to understand complex phenomena in public spending and the effects of transfers.

The estimates made show that regional spending has inertial behavior, meaning that the current level of regional spending is highly dependent on the level of spending in the previous period. The analysis model reflects this by using regional spending from the previous period as one of the explanatory variables, resulting in a significant coefficient. In this context, the coefficient of regional spending lagged by one period is significant, indicating that spending in the current period tends to follow the spending pattern of the previous period. This reflects the existence of spending inertia, where local governments tend to maintain or continue existing spending patterns rather than make drastic changes. Various factors, such as administrative habits, existing budget structures, or resistance to significant changes in spending, can cause this behavior. This spending inertia has important implications for public policy planning and evaluation. Knowing that regional spending tends to follow previous patterns can assist in designing more effective and realistic interventions, as well as anticipating the long-term impacts of changes in transfer or fund allocation policies. Policymakers can develop more appropriate strategies to encourage positive changes in regional budget management if they understand this inertial behavior.

The researchers revealed that there is asymmetric behavior in total spending, known as fiscal induction. These findings suggest that the response to changes in transfers is asymmetric. Reducing transfers tends to cause a larger decrease in local expenditure than increasing them. The larger decrease in expenditure when transfers are reduced may be due to the inability of local governments to adjust budgets quickly or the psychological effect of reduced funds that encourages drastic reductions in spending. Conversely, the

less significant increase in expenditure when transfers increase implies that local governments might be hesitant to implement significant budget changes or boost unnecessary spending without the long-term assurance of additional funds. These findings underscore the disparity in spending reactions to transfer modifications, where a reduction in transfers leads to a sharper decline in spending. This may have an impact on local fiscal planning and policy, highlighting the importance of considering this dynamic when designing government transfer and budget policies.

The study of expenditure disaggregation confirms the findings of the flypaper effect but shows differences in spending responses by category. The flypaper effect indicates that transfers from the central government cause a larger increase in local spending compared to increases in local revenues, with allocations that may be more focused on infrastructure projects than operational spending. The effect reflects regions' tendency to follow other regions' spending patterns, particularly in certain sectors such as education. However, responses to changes in transfer funds vary depending on the type of expenditure. On the other hand, a reduction in transfers could result in significant reductions in non-priority spending or new projects, while maintaining spending on essential categories. These findings highlight the importance of considering specific spending categories in designing policies to better understand spending dynamics.

The study shows strong inertial spending behavior in the public administration, road infrastructure, and social welfare sectors, with significant spending coefficients reflecting stability and continuity in spending from year to year in these sectors. Local governments tend to maintain the same level of spending in these sectors, indicating stability in budget management. In contrast, in the health and urban special services sectors, inertial behavior is not significant. The spending coefficients in these two sectors show greater fluctuations, indicating that spending is more responsive to changing conditions and needs.

CONCLUSION

The conclusions of this analysis reveal several key findings related to local spending behavior and the impact of central transfers. The analysis shows that bureaucratic behavior at the city government level does not conform to the traditional model that assumes utility maximization based on median voter preferences but rather tends to expand public budgets and projects. Strict monitoring and accountability are crucial to align allocations with the public interest. The analysis also identifies spending inertia in the public administration, road infrastructure, and social welfare sectors, where spending

follows the pattern of the previous period, while the health and urban special services sectors show larger fluctuations. The findings also reveal fiscal induction, where a reduction in transfers leads to a sharper decline in spending, while an increase in transfers highlights an imbalance in spending responses that impacts local fiscal planning and policy.

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