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Analysis of PAD, Investment, and Transfer Funds on Public Spending and Economic Growth in East Java

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PAD, Investment, Transfer Funds, Puclic Spending, Economis Growth

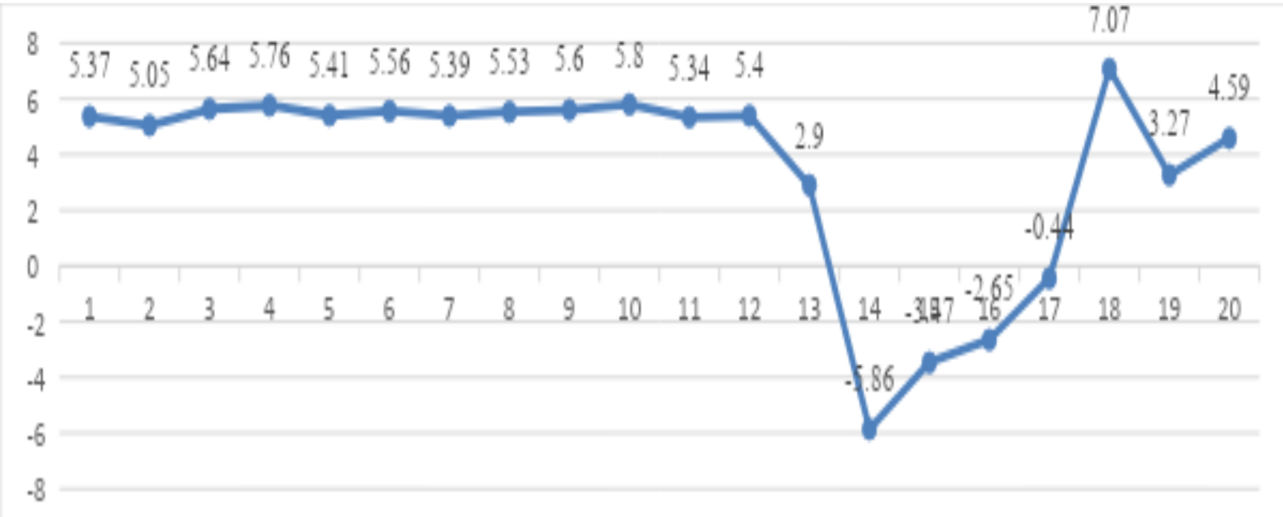
Abstract

Economic growth is measured through various indicators that can depict the economy of a region. The purpose of this research is to seek knowledge about the influence of regional original income (PAD), investment, and transfer funds on public expenditure, as well as the economic development of East Java for the period 2017-2021. The method used is quantitative descriptive, and path analysis is employed on panel data. The research is conducted using secondary data obtained from the Ministry of Finance and BKPM, which includes time series data for the period 2017 to 2021 and cross-sectional data consisting of 38 cities/districts, hence referred to as panel data. The results of the research indicate that the variables of regional original income (PAD) and transfer funds have a significant influence on public spending. However, the investment variable does not have a significant impact on public expenditure. Regional original income and investment have a significant impact on economic growth. On the other hand, public spending and transfer funds do not significantly affect economic growth.

1. Introduction

In implementing development in each region, it is hoped that economic growth will increase and achieve equality. The economic conditions of a region can be represented by economic growth in a certain period. This is because indicators of the success of economic development are measured through economic growth. The Central Statistics Agency explained that in the 2017-2019 period, East Java's economic growth rate experienced a stable pattern of decline and increase at 5%. Meanwhile, from 2020 to 2021 economic growth rates experienced fluctuations. In the first quarter of 2020 the value decreased to 2.9% until in the second quarter it experienced a drastic decline reaching -5.86%. Then it rose slowly until in the second quarter of 2021 it reached 7.07%, although it fell again in the third quarter of 2021 and after that it increased again in the fourth quarter of 2021. East Java's economic growth in the 2017-2021 period is presented in Figure 1.

Figure 1. East Java Economic Development Rate 2017-2021



Source: Central Statistics Agency (2022)

The increasing performance of economic development in the East Java region in the fourth quarter of 2021 is supported by improved performance in the investment sector, household consumption and foreign exports. This encourages economic growth by increasing domestic demand as seen from high consumption growth in households and the investment sector. One of the main components in economic development is investment support that comes from economic growth (Arsyad, 2012). Capital stock will increase if investment goes well. This will trigger increases in productivity, production quality and capacity which will increase economic growth. The increase in the performance of domestic demand and external demand will stimulate higher investment growth. With increased investment, economic growth will be encouraged and create effective demand (Dharma and Djohan, 2015).

State expenditure and revenue budgets are determined annually openly using law. This is done as an implementation of state financial management. APBN policies are implemented to increase efficiency and spending on goods to stimulate fiscal space. State spending is a form of government realization of work plans in development mechanisms. Shopping will be designed through several stages so that the shopping process can be carried out in a controlled manner. Public spending policy aims to answer strategic challenges and issues, responding to the economy. The aim is to fulfill development goals and targets which will later be realized in the state financial management system (good governance). The structure of public spending must represent economic growth and macro stability, as well as the provision of public goods (Hutahaean, 2019).

Resource management in the economic development process requires the performance of the government and society. Regional governments are really needed to manage funds from the central government to finance the implementation of development in the regions. Apart from that, regional governments are required to find regional financial sources. So that regions do not have dependence on assistance from the center. The central government allocates Special Allocation Funds (DAK) and Village Funds in the "State Revenue and Expenditure Budget (APBN)" as an effort to accelerate regional development and achieve national priority goals. The central government provides funds to regions using the principle of authority, so that regional government affairs can be carried out independently. This authority is exercised through fund transfers which include Special Allocation Funds (DAK), Profit Sharing Funds (DBH), and General Allocation Funds (DAU). Since the 2020 fiscal year, transfers of regional and village funds from the central government have been changed through direct transfers to speed up the use of funds and achieve maximum results.

Apart from transfer funds, another source of funding that can optimize regional funding is Regional Original Income (PAD). PAD is revenue from the region which originates from levies from taxes in the region, levies from the region, the results of management of regional assets which are separated, and others (Rori et al., 2016). The ability of a region to carry out development programs and activities for regional government is determined through original revenue from the region. However, in practice, many regions have a PAD construction structure that is relatively small compared to regional income, while the majority of revenue actually comes from government income. For this reason, it explains that regional governments are dependent on the central government. Meanwhile, original revenue from the regions is used as the largest source of finance which is supported by the policy of balancing finances from the center. Therefore, regional governments must depend as little as possible on central government assistance (Suharlina, 2019). Based on the principle of increasing independence in the implementation of development, the funds used for the development costs of regional governments should come from their respective financial capabilities. Therefore, the potential of regional governments regarding financing of their own household affairs needs to be increased as much as possible by exploring all potential sources of funding that exist in the regions.

This research aims to find out what the direct and indirect effects of local revenue, investment and transfer funding are on public spending and economic development in East Java Province for the period 2017-2021. The results used in the research are expected to be able to provide an explanation regarding the magnitude of the direct and indirect influence for variables X1, X2, X3 on Y1 and Y2.

2. Literature Review

2.1 Regional Original Income (PAD)

Original Regional Income is revenue from a region which has its source in the economy of that region. In accordance with Law No. 22 of 2008, it is defined as one of the sources of income obtained in the form of taxes for the region, levies from the region, and legal management of regional assets. Regional income which falls into the low category can cause regional financial processing to decline. Genuine income from a region can be identified by determining and determining the source of the original income from that region. It is hoped that the source of revenue can be managed as well as possible, so that blood financial management improves (Effendi et al., 2017).

2.2 Investment

Investment is a factor which is a driving force in increasing economic growth. Expenditures that can increase the economy in producing goods and services are capital formation (Harrod and Domar, 1957). Or as expenditure that can form effective demand. Apart from that, investment has an influence on technological progress. Which will encourage industrialization, extraction of natural resources and market expansion to advance the economy

.

2.3 Transfer Funds

Transfer funds are a transfer instrument in financial administration allocated for development funding. Based on Law No. 33 of 2004 article 1 paragraph 19 states that transfer funds are funds which originate from the budget and are used to finance regional activities in implementing the decentralization system. These funds have three types, including funds for profit sharing, funds for special allocations, and funds for general allocations. This policy is intended to finance programs that have a direct or indirect impact on society (Amelia & Ekobelawati, 2018).

2.4 Public Spending

Public spending is spending that has a direct impact on citizens. Where this is realized in the provision of education, health and infrastructure services. According to the HKPD Bill articles 140-145, regional expenditure funding is prioritized for basic public services, namely education, health and infrastructure spending. The amount of public spending can be seen from how much funds are allocated for capital expenditure. Most of the transfer funds are used for personnel spending and operational spending, while public spending allocations are still minimal (Azwar, 2022).

2.5 Economic growth

The development of the country is seen from the perspective of economic growth. If economic growth increases, then development in a country will get better. Apart from that, economic prosperity will also increase. Economic growth can continue to increase because it is influenced by many factors. Consists of three components that are used as determinants of economic growth, including accumulation of capital, population growth, and improvements in the technology sector (Todaro and Smith, 2003).

3. Research Methods

The research model used in the research is quantitative descriptive analysis. The descriptive analysis research model is a method that describes the current situation, then the data obtained is analyzed and interpreted. The data used in the form of secondary data comes from the Indonesian Ministry of Finance and BKPM. The data is in the form of panel data or pooled data, namely times series data for the 2017 to 2021 range as well as cross-section data which consists of 38 cities/districts. The places where the research was carried out were all cities/districts in the province of East Java, namely 38 cities/districts. The variables for research have 2 dependent variables in the form of public spending and economic growth, then there are 3 independent variables in the form of original regional income, investment and transfer funds.

The current research uses data analysis techniques in the form of path analysis. Path analysis is an extension of multiple linear regression analysis which has the possibility of analyzing a model with a complex structure. This analysis technique is used to search for both direct and indirect impacts. In this research the classical assumption test was not used. According to Gujarati Theory, panel data studies data in a complex manner, provides more information, and increases the degree efficiency of the model, so classical assumption tests are not needed. The path analysis model in this research is presented in Figure 2.

The structural equation model used is as follows:

1. Substructure value 1

Y1 = PY1X1+PY1X2+PY1X3+e1

2. Value substructure 2

Y2 = PY2X1+PY2X2+PY2X3 +PY2Y1+e2

Description:

X1= PAD

X2= Investment

X3= Transfer Funds

Y1=Public Spending

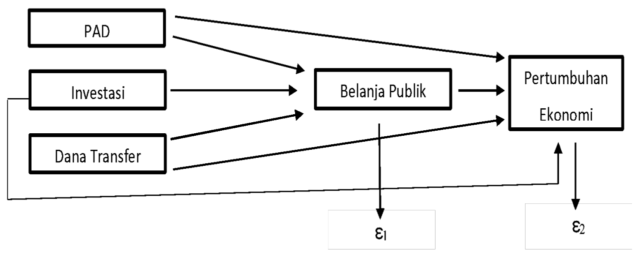
Y2= Economic Growth

P= Regression coefficient

e1= Other variables influence Y1

e2= Other variables influence Y2

Figure 2. Path Analysis Model



4. Result and Discussion

4.1 Research result

The results of the analysis on substructure 1 are shown in Table 1, Table 2, Table 3.

Table 1. Model Summary

Model	R	R Square	Adj. R Square	Std. Error of the Estimate
1	,978[a]	,956	,955	2,761E+11

Source: data processing from SPSS

Table 2. ANOVA

Model	df	Mean Square	F	Sig.
Regresi	3	1,028E+26	1348,690	,000[b]
Residu	186	7,621E+22		
Total	189			

Source: data processing from SPSS

Tabel 3. Coeffisient

Model	Unstd. Coeffisien		Std. Coeffisient	T	Sig.
	B	Std Error	Beta		
X1	1,137	,034	,690	33,548	,000
X2	,009	,007	,024	1,212	,227
X3	1,068	,038	,470	28,412	,000

Source: data processing from SPSS

The results of the analysis on substructure 2 are shown in Table 4, Table 5, and Table 6.

Table 4. Model Summary

Model	R	R Square	Adj. R Square	Std. Error of the Estimate
1	,947[a]	,896	,894	2,155E+13

Source: data processing from SPSS

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Table 5. ANOVA

Model	Df	Mean Square	F	Sig.
Regresi	4	1,853E+29	398,766	,000b
Residu	185	4,646E+26		
Total	189			

Source: data processing from SPSS

Table 6. Coefficient

Model	Unstd. Coeffisien		Std. Coeffisient	t	Sig.
	B	Std Error	Beta		
X1	60,786	7,027	,728	8,650	,000
X2	1,841	,585	,095	3,147	,002
X3	-10,992	6,784	-,095	-1,620	,107
Y1	11,042	5,725	,218	1,929	,055

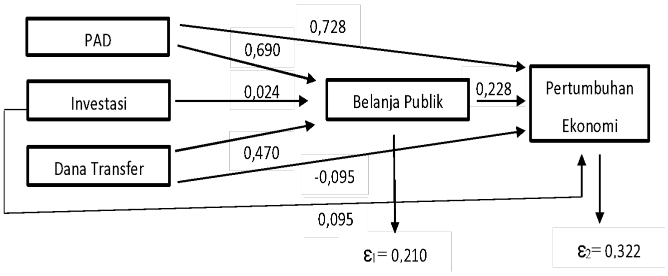
Source: data processing from SPSS

The path equation model is as follows:

$$\text{Value } \varepsilon 1 = \sqrt{(1-0.956)} = 0.210$$

$$\text{Value } \varepsilon 2 = \sqrt{((1-0.896))} = 0.322$$

Figure 3. Substructure equation model 2



The results of the analysis carried out in substructure model 1 show that PAD, investment and transfer funds have an influence on public spending. The magnitude of the contribution of local original income, investment and transfer funds to public spending can be seen from the R Square value. The R Square value is 0.956, this shows that the contribution of local revenue, investment and transfer funds to public spending in East Java is 95.6%, while the remaining 4.4% is influenced by other variables not included in the research.

The results of data analysis carried out in substructure model 2 show that PAD, investment, transfer funds and public spending have an influence on economic growth. The magnitude of the contribution of PAD, investment, transfer funds and public spending to economic growth can be seen from the R Square value. The R Square value is 0.896. This shows that the contribution of PAD, investment, transfer funds and public spending to economic growth in East Java is 89.6%, while the remaining 10.4% is influenced by other variables not included in the research.

4.2 Discussion

a. The Influence of PAD on Public Expenditures

The results of substructure analysis 1 for local revenue and public spending explain that the coefficient is 0.690 with a significance level of 0.000 (0.000 < 0.05) where regional revenue has a positive and significant influence on public spending. The results obtained are in accordance with the analysis of Mawarni et al. (2013) who found that local revenue has an important influence on capital expenditure.

Based on the analysis, it can be explained that every increase or decrease in PAD will affect the increase or decrease in public spending. Throughout 2017-2021, the realization of PAD and public spending experienced increases and decreases. In 2017, PAD realization was IDR 37,263,120,000,000 and public expenditure was IDR 9,459,230,940,909. Then the realization of PAD in 2018 increased to IDR 37,286,320,000,000 and public spending amounted to IDR 9,565,136,564,642. The highest increase in PAD realization occurred in 2019, namely IDR 39,344,670,000,000 and public spending of IDR 10,337,959,633,274. However, PAD realization decreased in 2020, namely IDR 37,042,890,000,000 and public spending amounted to IDR 8,981,078,339,158. Then the realization of PAD in 2021 increased to IDR 40,942,410,000,000, while public spending amounted to IDR 9,269,944,609,147.

Based on the analysis carried out, it shows that original regional income has a significant influence on public spending. If original regional income increases, public spending will also increase and vice versa. These results are reinforced by Rahman's research, (2018) meaning that local income has an influence on capital expenditure. As well as the findings of Sofiyani and Subadriyah, (2020) that original regional income influences regional spending.

b. The Influence of Investment on Public Spending

The results of the analysis of substructure 1 between investment and public spending obtained a coefficient of 0.024 which has a significance of 0.227 (0.277 > 0.05), where investment has a positive coefficient value but does not have a significant effect on public spending. Any increase in investment has no effect on increasing public spending. Throughout 2017-2021, investment realization in East Java continues to experience a positive trend. This can increase economic growth and investment, thus opening up jobs and increasing production. However, the increase in the rate of investment has not been able to increase the amount of public spending. This result is different from the findings of Yusiawati & Marhaeni (2020) that investment significantly and positively influences capital expenditure.

c. The Effect of Transfer Funds on Public Expenditures

The results of substructure analysis 1 between transfer funds and public spending show a coefficient value of 0.470 and a significance of 0.000 (0.000 < 0.05). Where transfer funds positively and significantly influence public spending. Every increase or decrease in transfers to regions will influence the proportion of public spending to increase or decrease.

In 2017, the proportion of public spending was IDR 9,459,230,940,909 of the total transfer to regions, namely IDR 65,677,800,000,000.00. In 2018 the proportion of public spending increased by IDR 9,565,136,561,642 from total transfers to regions, namely IDR 69,501,880,000,000. In 2019 the proportion of public spending increased by IDR 10,337,959,633,274 from total transfers to regions, namely IDR 71,908,430,000,000. In 2020 the proportion of public spending decreased by IDR 8,981,078,339,158 from total transfers to regions, namely IDR 67,063,610,000,000. In 2021 the proportion of public spending will increase by IDR 9,269,944,609,147 from total transfers to regions, namely IDR 71,375,706,000,000. Based on these data, it can be seen that every increase in transfer funds will increase the proportion of public spending and every decrease in transfer funds will reduce the proportion of public spending.

Increasing the proportion of public spending each year will improve quality public services. Transfer funds intended for regional funding are allocated properly so that regional independence and community prosperity can be realized. These results are in accordance with the findings of Wati & Fajar, (2017) that transfer funds significantly influence regional spending in Bandung City.

d. The Influence of PAD on Economic Growth

Based on the analysis of substructure 2, a coefficient value of 0.728 was obtained which has a significance value of 0.000 (0.000 < 0.05). Thus, local original income has a positive and important influence on economic growth. Economic growth has increased due to increased local income. Therefore, the income obtained by regional governments will increase, which will encourage initiatives in seeking regional capabilities to increase economic growth.

East Java's PAD in 2017 was IDR 37,263,120,000,000 and GRDP was IDR 2,012,918,000,000,000. Then in 2018 PAD increased by IDR 37,286,320,000,000 and GRDP amounted to IDR 2,188,766,400,000,000. Realized PAD in 2019 increased by IDR 39,344,670,000,000 and GRDP by IDR 2,345,548,600,000,000. However, the realization of PAD decreased in 2020 amounting to IDR 37,042,890,000,000 and

GRDP amounting to IDR 2,299,791,100,000,000. Then the realization of PAD in 2021 will increase by IDR 40,942,410,000,000 and GRDP by IDR 2,454,498,800,000,000.

Economic growth will increase if PAD is higher. Increasing PAD is the key to success in achieving regional development goals. The results of the research are in accordance with the research of Saraswati & Ramantha, (2018) which states that local income and economic growth have a significant and positive influence on each other in the districts/cities of Bali Province. Apart from that, Wahyuni, (2020) who conducted research on PAD and economic growth in the Surakarta City area had the same statement.

e. The Effect of Investment on Economic Growth

Substructure analysis 2 between investment in economic growth shows a coefficient of 0.095 which has a significance value of 0.002 (0.002 < 0.05). For this reason, it can be explained that investment has a positive impact and is important for economic growth. For 2017 to 2018, investment realization decreased from 66.5% to 51.2%. After experiencing a decline, East Java investment realization began to rise the following year. In 2019, investment realization was 58.5%, then experienced an increase of 78.3% in 2020. Investment realization in 2021 was the highest in the last 5 years, namely 79.5%. Investment experiences a continuous increase which provides encouragement and increases the growth rate of the economy. This statement is in line with the theory put forward by Harrod and Domar regarding economic growth, where investment is an indicator that drives economic growth.

In this research, it is stated that economic growth is significantly influenced by investment. Thus, if there is an increase in investment, there will be an increase in economic growth. The results obtained are in line with the analysis of Arlintang et al. (2018) which explains that investment and economic growth have a significant influence in the Special Region of Yogyakarta. And reinforced by the analysis carried out by Winarni et al. (2020) regarding investment which has a positive and important influence on the growth of the economy in the Central Java region.

f. The Effect of Transfer Funds on Economic Growth

The results of substructure analysis 2 between transfer funds in the growth of the economy show a coefficient size of -0.095 and a significance level of 0.107 (0.107 > 0.05). Therefore, transfer funds have no influence on economic growth. The utilization of transfer spending to regions in East Java throughout 2017-2021 was dominated by personnel spending. Transfer funds that should be allocated for development and infrastructure spending to encourage economic growth each year do not meet the allocation percentage. In five years, the highest average percentage used for personnel spending allocation was 33%, while the average percentage allocation for development and infrastructure spending was only 15%. In the APBN Law, transfer funds whose use is directed have a percentage of at least 25% in spending on facilities and infrastructure for the regions.

Allocation of transfer funds that are inappropriate and not on target results in regional development priority targets not being achieved. Fund transfers in the growing economy to research do not have an important effect. This means that every increase in transfer funds has not been able to provide a boost to economic growth. Research conducted by Pasa at al. (2023) stated that transfer funds do not have an important influence on economic growth.

g. The Influence of Public Spending on Economic Growth

Based on substructure analysis 2, namely the influence of public spending on economic growth, a coefficient of 0.218 was obtained which has a significance value of 0.055 (0.055 > 0.05). So, public spending and economic growth do not have an important influence. In this case, it means that the increase in economic growth is not influenced by the allocation of the public spending budget. This is because most of the expenditure allocation is used for expenditure from employees and procurement of goods, and capital expenditure has a small value. The small portion of capital expenditure causes the formation of gross fixed capital and infrastructure, which is unable to encourage economic growth.

Throughout 2017-2021, the portion of indirect spending averaged 70% and direct spending was 30%. Based on this spending portion, it is known that government spending dominates compared to spending for economic infrastructure development. Components of direct spending include spending on employees, spending on goods and services, and spending on capital. The average capital expenditure over five years is only 8% of total regional expenditure. This causes infrastructure development to be very limited, so it cannot stimulate the rate of economic growth. The results obtained are in line with Fanggidae's (2019) research that regional spending does not affect economic growth.

h. Indirect Influence

The indirect impact can be explained from the magnitude of the significance of the intervening variable on the dependent variable (Riduwan, 2007). If there is no significant influence between the two, the intervening variable cannot be an intermediary between the independent variable and the dependent variable. Based on the results obtained, the significance value of the public spending variable on economic growth is 0.055. It does not have an important influence on public spending on economic growth due to a significance value greater than 0.05. It can be concluded that the public expenditure variable cannot mediate the original regional income variable, the investment variable, and the transfer fund variable for the economic growth variable.

5. Closing

5.1 Conclusion

In substructural model 1, each exogenous variable has a different influence on the endogenous variable. First, the regional original income variable is significantly public expenditure. Second, the transfer fund variable significantly influences public spending. Third, investment variables significantly influence public spending.

In substructural model 2, each exogenous variable has a different influence on the endogenous variable. First, local original income has an important influence on economic growth. Second, investment has an important influence on economic growth. Third, transfer funds do not significantly affect economic growth. Fourth, public spending significantly influences economic growth. There is no indirect impact for independent variables and dependent variables through intervening variables. This is because the public spending variable does not affect economic growth.

5.2 Suggestion

The recommendation from the research carried out by the author for the East Java provincial government is to try to explore the potential of original regional financial sources, so that they do not depend on transfer funds and can advance the region and encourage economic growth. Apart from that, investment can be optimized to encourage economic growth by reconstructing labor-intensive investments and establishing partnerships with business players.

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