# CHAPTER I

# INTRODUCTION

## 1.1 Background

Since the beginning of the economic crisis, triggered by the mid-1997 monetary crisis, development in Indonesia has stopped partly due to the government's inability to finance development projects because the government revenues decreased, particularly from the tax and retribution sectors. The repercussion of decreased revenues led to some weaknesses of the national economy. The uneven distribution of development implementations resulted in the growth gap among urban and rural, western and eastern parts of Indonesia, and among social groups, causing the occurrence of social turmoil easily.

In order to face the above problems as an effort to support the implementation of national development, the government provides an opportunity to organize regional autonomy by issuing Law Number 32 Year 2004 regarding Regional Government and Law Number 33 Year 2004 regarding Financial Balance between Central Government and Regional Government. These laws gives rights and obligations to the Regional Governments to regulate and manage their own governmental affairs and the interests of Regional communities in accordance with the laws and regulations. The fundamental consideration of the implementation of Regional Autonomy is the development of an environment in the country which would indicate that the people want openness and independence in general.

Regional autonomy itself is the right, authority, and obligation of autonomous regions in order to arrange and manage their own government affairs and interests of the society in accordance with the law. Regional Autonomy is arranged in the provision of MPR RI Number IV / MPR / 2000 on Policy Recommendation in the Implementation of Regional Autonomy, so that regional autonomy can be interpreted as an authority to regulate their own regions and, explore the potential that each regions possesses. Under regional autonomy, Regional Government is expected and required to perform the regional financial management in an effective, efficient and accountable way. Regional Government should strive to manage the Regional revenue carefully, precisely and accurately. This applies to all provinces in Indonesia including West Sumatra Province. West Sumatera Province is an area with abundant natural resources, and one of the popular tourist destinations in Indonesia, so West Sumatera Province has the potential to increase its revenues in the name of tax and retribution sector in particular. A lot many efforts has already been made by the local government to explore the source of revenues which would result in the increase of regional income itself.

The main feature that indicates that an area is an autonomous region lies in the financial capacity of the region, which means it must have the authority and ability to extract their own financial resources, while the dependency on the central government is kept to a minimum. The balance between central government and local government can be said to be ideal if every level of government can manage its finances optimally. The implications of autonomy granting requires regions to implement development in all aspects, especially in the construction of public facilities and infrastructure. This development is

expected to be carried out independently by the regions in terms of planning, development and financing. This can be done through enhancing the rights and responsibilities of local governments to manage their own households also accelerating economic growth and regional development, reducing regional gaps and improving the quality of public services to be more efficient and responsive to the needs, potentials and characteristics of people in their respective regions (Ariyani, 2009).

This is a form of correction in the implementation of economic development which previously focused the development more to the center and less to theregional development. The previous centralized policy led to disparities and imbalances in the implementation of development at the central and regional levels. As a result almost all economic potential in the region is sucked into the center compromising the development of the region. Thus, with regional autonomy, there is a way to remedy errors by providing opportunities for regions to gain more funds and authority to manage their regional potentials.

The image of regional independence in autonomy area can be known through how grand is the ability of the particular region's finance resources are to develop its area. Regional financial independence indicates the ability of local governments to finance governmental activities, the development and services to communities that have paid tax and retribution as a necessary source of income. Regional financial independence can be seen from the amount of regional revenue earned by each Regency and City government. The greater the regional own revenue (PAD) is, in comparison to the central government's grants, the Regency and City government is said to be independent. So far, the largest source of

regional own revenue (from year to year) is still derived from the balance funds (the same happens in West Sumatera Province), rather than from the regional own revenue which should be the main source of local revenue. This shows that the region (West Sumatera Province) is still very dependent on the central government. It can be proven by the data below, that shows the contributor of Regional Own Revenue (PAD) to regional income is still smaller than the contributor of Balancing Fund in year to year in West Sumatera Province:

Table 1.1
Realization of Regional Reception in West Sumatera Province 2014-2016 :

| Year | 2014 | 2015 | 2016 |
|---|---|---|---|
| **Regional Own Revenue (PAD)** | **1 348 654 955,03** | **1 576 555 593,60** | **1 683 226 171,34** |
| Regional Tax | 389 573 431,42 | 431 627 174,71 | 474 137 802,26 |
| Regional Retribution | 323 497 145,46 | 227 912 245,89 | 164 953 632,51 |
| Proceeds from the management of regional assets set aside | 136 357 283,93 | 137 692 283,15 | 150 033 521,28 |
| Other Areas of legitimate revenue. | 499 227 094,22 | 779 323 889,85 | 894 101 215,28 |
| **Balancing Fund** | **12 077 514 326,00** | **12 732 290 100,24** | **15 407 122 288,49** |

*Sources: Financial Statistics of Provincial and Regency and City Government of West Sumatra*

Based on the data above we can see that the number of contributor funds in West Sumatera Province still depends on the central government which is derived from the balancing fund, whereas the number of contributor from regional own revenue is still smaller than the number contributor from balancing fund. PAD is the main asset in measuring the regional financial independence. If the PAD structure is strong, then the region has a strong financing capability which can

reduce the level of regional dependence on the central government. With the reduced dependence on central government, a region can be categorized as independent. Regional income sources are: (1) Regional own revenue, (2) Balancing Funds, (3) Other Legal Revenues.

To reduce the dependence on the flow of funds gained from the central government, regions should be able to explore potential sources coming from their own regions through their Regional own revenue. PAD should be a part of the largest financial resources because PAD is the most important benchmark for regional capability in regulating and realizing regional autonomy, reflecting the independence of a region, considering a measure of independence of a region as minimal reliance on central aid. PAD is a source of local government financing whose role is highly dependent on the ability and willingness of the region in exploring the potential that exists in the region. Sources of PAD itself comes from: (1) regional tax, (2) regional retribution, (3) Proceeds from the managementof regional assets set aside (4) Other Areas of legitimate revenue.

Regional tax and Regional retribution are one of the most important sources of Regional own revenue because each year regional tax and regional retribution are able to contribute substantially to Regional own revenue. This is also supported by Law no. Law No. 34 of 2000 on the amendment of Law no. 18 of 1997, on local taxes and levies, as an effort to realize broad regional autonomy, real and responsible. So it is expected to become one of the great regional government revenue sources in increasing regional financial independence. Nevertheless, until now the average of tax revenue in all regions in Indonesia is still relatively small.

Tax is one of the largest PAD-forming components. Regency tax revenues consist of hotel taxes, restaurant taxes, entertainment taxes, advertisement taxes, street lighting taxes and parking taxes, each contributing differently. In addition to regional Taxes, regional retribution is also an important component of regional income. Regional retribution can be classified into public service retribution, business service retribution, and certain permits retribution.

In its development, the implementation of regional autonomy was not accompanied by the financial mandate of regional government. This reflects the dependency of regional government on funding from the central government, it is therefore, a phenomenon in this study regarding the regional financial independence. Several factors that can determine the amount of regional own revenue that is the subject of study in this research is about the amount of regional tax revenues and regional retribution and an effective effort tofind out whether regional taxand regional retribution simultaneously or partially affect the increase of regional own revenue which can then effect regional financial independence in order to arrange and manage their own government affairs and interests.

**1.2 Problem Statement**

Based on the description of the background above, the problem it can be formulated as follows:

1.   Whether the Regional Tax partially has significant effect on the regional financial independence at Regency and City Government in West Sumatera Province?

2. Whether Regional Retribution partially has significant effect on the regional financial independence at Regency and City Government in West Sumatera Province?

3. Whether Regional Tax and Regional Retribution simultaneously have significant effect on the regional financial independence at Regency and City Government in West Sumatera Province?

## 1.3 Research objective

In accordance with the formulation of the problem, the objective to be achieved in this study is:

1. To determine whether Regional Tax partially has significant effect on the RegionalFinancialIndependence at Regency and City Government in West Sumatera Province.

2. To determine whether Regional Retribution partially has significant effect on the RegionalFinancialIndependence at Regency and City Government in West Sumatera Province.

3. To determine whether Regional Tax and Regional Retribution simultaneously have significant effect on the RegionalFinancialIndependence at Regency and City Government in West Sumatera Province

## 1.4 Research benefit

1. For the author

This research is to add insight about the effect of Regional Tax and RegionalRetribution on RegionalFinancialIndependence at the government in West Sumatra province.

2. For the  Government in West Sumatera province

The results of this study are expected to be used as information input in the form of empirical evidence of the influence of Regional Tax and RegionalRetribution on RegionalFinancialIndependence at the government in West Sumatra province, as well as input in the preparation of APBD of the  Government in West Sumatra Province in the coming years.

3. For the Central Government

The results of this study as one of the decision-making materials in the case of the successful assessment of the implementation of Regional Autonomy at the  Government in West Sumatra Province compared with other regions.

4. For Prospective Authors

The results of this study are expected to serve as one of the reference for further research, especially students who conduct research related to the effect of Regional Tax and RegionalRetribution on the Regional Financial Independence.
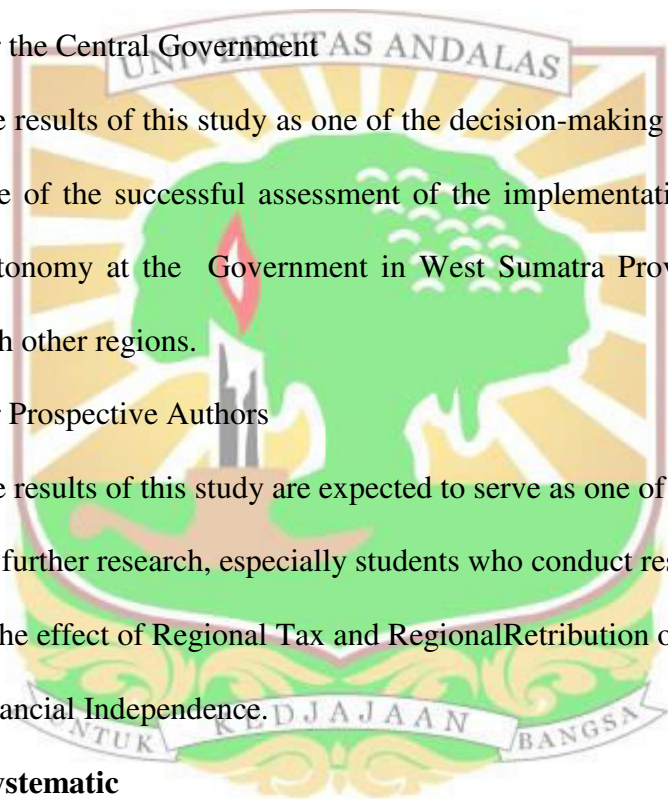
## 1.5 Writing systematic

Writing system in this research consist of Chapter one is about introduction, in this chapter will explain the background of the problem, problem statements, objectives and benefits of the research, as well as the systematic writing. In chapter two is literature review which contains theory, review researches and hypothesis development, in this chapter will be discuss about theory and concept of regional tax, regional retribution and regional financial independence. Chapter

three is about research method, this chapter will be explain the type of research, data sources, data collection techniques, population and sample, operational definition and variable measurement, model and data analysis techniques and testing hypothesis.

Next is chapter four about analysis data and explanation, this chapter will explain the description of West Sumatera region, analysis ratio of regional tax, regional retribution and regional financial independence, also describes about the analysis result of the processing data by SPSS. Last, is about the conclusion, suggestion and the limitation of the research which are contained in chapter five.