

# CHAPTER I

## INTRODUCTION

### 1.1. Background

The development strategy of a country should be able to increase human resources in a sustainable manner. However, the reality of overall national development cannot be done only by managing the authority of the central government. Local governments should be able to manage its resources efficiently and effectively, which can be realized by changing the order of the management in running the government, which previously adopted the centralized system to decentralize through regional autonomy. Decentralization has resulted in regional governments being able to increase their regional resources (Basri, 2012). According to Sukarna (2013) regional autonomy is very broad because the regional government has the authority to take care of the interests of its own people which consists of education, agriculture, welfare, health, housing, economy and others, which is expected to accelerate the rate of regional development.

The government launched a regional autonomy policy through Law Number 22 of 1999 concerning Regional Government, which is also stipulated in Law Number 32 of 2004 concerning Regional Government as amended lastly by Law Number 23 of 2014. In addition, it is also contained in Law Number 25 of 1999 concerning Financial Balance between Central and Regional Governments which was revised with Law Number 33 of 2004. In these Constitutions it is mandated that local

government be given the right, authority, and autonomy obligations to regulate and manage its own government affairs and the interests of local communities in accordance with statutory regulations and is expected to carry out development in all fields carried out independently by the region, in terms of planning, development and financing. Specifically, local governments must be able to allocate regional spending through development spending in supporting sectors to increase human development. This authority aims to bring government services closer to the community, and make it easier for the public to monitor and control the use of funds sourced from the Regional Budget.

The public sector budget contains planned activities for obtaining revenue and expenditure in monetary units. All local government revenues and expenditures, whether in the form of money, goods and services in the fiscal year, must be financed in the Local Government Budget (Kawedar et al., 2008). According to Government Regulation Number 58 of 2005 which was revised with Government Regulation Number 12 of 2019, the Local Government Budget (APBD) is the annual financial plan of the Regional Government which is discussed and agreed upon by the executives and the legislatives, and stipulated by a Local Government Regulation. Ministry of Home Affairs decree No. 29 of 2002 implies that for the purpose of accountability for the management of the funds under its management, the Regional Government is required to prepare regional financial statement as part of the accountability report of the regional head,

which includes the balance sheet, budget realization report, regional budget calculation note, and cash flow. Which is the basis for regional financial management which is a guideline for regional governments in providing services to the public within one fiscal year. From the Local Government Budget report, it can be analyzed the source and use of funds by regional governments during one fiscal year (Halim, 2002).

The regional government allocates funds in the form of a Capital Expenditure budget in the Regional Revenue and Expenditure to produces output in the form of fixed assets (Syukriy, 2004). Law Number 32 of 2004 assert that regions have the authority to determine the allocation of resources to Capital Expenditures by adhering to the principles of propriety, needs and capabilities of the region. Sarangih (2003) suggest that the use of spending should be allocated to productive things such as to carry out development activities, including development on public welfare.

Mardiasmo (2004) point out that one of the ways that local governments need to do in order to increase regional capacity and close fiscal gaps is through reforming local revenue management, which include management of locally-generated revenue and management of general allocation funds. According to Law No.32 of 2004, locally-generated revenue is a source of revenue from the Regional Government originating from the region itself based on its capabilities. With an increase in locally-generated revenue, it is expected to increase capital expenditure

investment in local governments so that the government provides good quality public services.

The consequence of the implementation of regional autonomy is that much of the budget that is actually intended to improve the welfare of the people must be allocated or must be diverted for the construction of government facilities, personnel expenditure, expenditure on goods and services, and other needs for the expansion of new autonomous regions. The more expansion regions, will have an impact on the proportional distribution of the General Allocation Fund to all regions. Badrudin (2012) revealed that the balance of the central and regional finances is a derivative of the regional autonomy policy as a consequence of the transfer of part of the authority of the central government to the local government. Law No. 25 of 1999 asserts that for the implementation of the authority of the Regional Government and the Central Government will transfer a balance of funds to the Regional Government. The intergovernmental revenue consists of the General Allocation Fund, the Special Allocation Fund, and the regional portion of the central tax revenue-sharing. According to Gunantara and Dwirandra (2014) the General Allocation Funds is sourced from the State Budget (APBN) which aims to allocate financial equality between regions for the costs of the region's needs in the implementation of decentralization.

The Central Government provides delegation of authority to the Regional Government accompanied by the transfer of funds in the form of

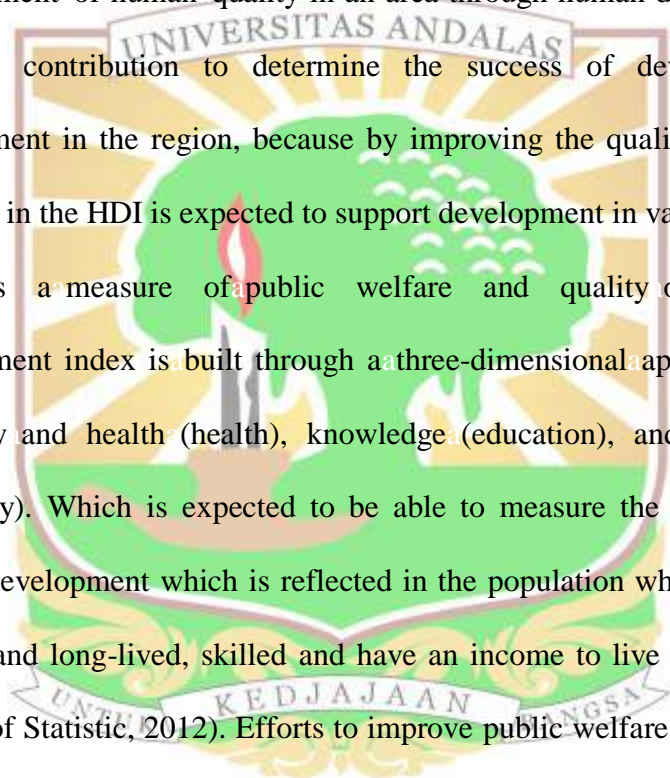
balance funds, namely the Special Allocation Fund. Based on Law No. 33 of 2004, the Special Allocation Fund is sourced from the Local Government Budget allocated to certain regions with the aim of assisting to fund special activities in the regional affairs and priorities of the region whose utilization is directed to the construction, procurement, improvement, improvement of facilities and physical infrastructure of services public with a long economic life. After the implementation of the decentralization system in 2001, the scope of activities financed by Special Allocation Fund increased, covering seven government service areas, namely: 1) Education, 2) Health, 3) Agriculture, 4) Public Works (roads, irrigation, and clean water), 5) Government Infrastructure, 6) Maritime Affairs and Fisheries, and 7) environment. If Special Allocation Fund is used wisely, it will have an impact on improving welfare of the community.

The description of Special Allocation Funds in general still has many obstacles, so that the absorption of Special Allocation Funds and the physical performance of activities cannot be said to be optimal. One reason is the lack of coordination with previous officials and the fact that there is no distribution of Special Allocation Funds by the Central Government, but also a lack of understanding in implementing Special Allocation Fund management policies. Even though the Special Allocation Fund is very important for the development of a region.

Decentralization or the granting of greater autonomy will provide a greater impact on economic growth, normatively if economic growth is high

then human development will increase (Setyowati, 2012). it can be said that the Increased revenue (PAD) and the General Allocation Fund (DAU) and Special Allocation Fund (DAK) as a product of decentralization enables the improvement of public welfare, if these funds are allocated appropriately and run according with a target (Sarkoro, 2016).One way to measure the level of welfare is through the Human Development Index. Improvement of human quality in an area through human development has a major contribution to determine the success of development and management in the region, because by improving the quality of people as reflected in the HDI is expected to support development in various fields.

As a measure of public welfare and quality of life, human development index is built through a three-dimensional approach, namely longevity and health (health), knowledge (education), and a decent life (economy). Which is expected to be able to measure the success rate of human development which is reflected in the population who are educated, healthy and long-lived, skilled and have an income to live decent (Central Bureau of Statistic, 2012). Efforts to improve public welfare through human development index cannot be separated from how local governments use locally-generated revenue for regional spending in sectors that can raise HDI such as education, health, and infrastructure. Especially in the current era of decentralization, the government is expected to be able to explore and utilize the resources of their respective regions and be allocated to improve the welfare of the community.



The increase in HDI caused by locally-generated revenue, general allocation funds, and special allocation funds has been widely studied by previous researchers, such as Kusnandar and Siswantoro (2012) which stated that locally-generated revenue, special allocation funds have a significant effect to the increase of HDI. While the research of Wiliantara and Budiasih (2016) states that local-generated revenue and general allocation funds do not affect the human development index.



The figure 1.1 above shows the Human Development Index value of Indonesia from 2010-2018. In the last 9 years HDI value for Indonesia has always increased every year. Indonesia experienced the highest increase of HDI value in 2018 for 71.35, and the lowest is in 2010 for 66.53. Although the HDI value of Indonesia increases every year, but the value of HDI in Indonesia has never been more than 80, which categorized as a 'very high' level in HDI according to The Central Bureau of Statistic and could be considered as an optimal level for HDI

Figure 1.2  
HDI of Province in Indonesia



The figure 1.2 above shows the Human Development Index from each province in 2018, with the range from 60-85. Based on the Figure 1.2 North Kalimantan Province Has the highest HDI than other provinces in Indonesia in 2018 for, while Papua Province has the lowest HDI than other provinces in Indonesia in 2018. And for Provinces in Sumatera as Aceh, North Sumatera, West Sumatera, South Sumatera, Lampung, and Riau in the middle level of HDI value.

From the description above, the research interested to conduct research on the impact of locally-generated revenue, general allocation fund and special allocation fund on human development index with capital expenditure as an intervening variable in Sumatera. Capital Expenditures are used as an intervening variable because this research aims to determine how much influence the locally-Generated Revenue, general allocation funds and special allocation fund on improving the welfare of the community is visible from the achievements of the human



development index through capital expenditure allocation. This statement is in accordance with research conducted by Ida Ayu Candra Yunita Sari and Ni Luh Supadmi (2013), which stated that capital expenditure have a significant impact on HDI.

## 1.2. Problem Definitions

Decentralization has given local governments the authority to manage their own government affairs and the interests of local communities in accordance with statutory regulations and is expected to carry out development in all fields carried out independently by the regions, in terms of planning, development and financing. It aims to increase regional capacity and close fiscal gaps, which can be done through local revenue management reforms, which include the management of capital expenditure, general allocation funds, and special allocation funds.

Regional revenue management reforms through decentralization are expected to increase economic growth. Normatively if economic growth is high then social welfare will increase. It is also expected to improve the public welfare which can be measured by HDI.

This study seeks to examine whether there is an impact of the revenue and fund received and allocate by the government in increasing the welfare of the community, and whether the capital expenditure

mediates the relationship between them. Therefore, the formulation of the problems examined in this study are as follows:

- a) Do locally-generated revenue, general allocation fund and special allocation fund have significant effects on capital expenditure of regencies and cities in Sumatera in 2015-2017?
- b) Does locally-generated revenue, general allocation fund, special allocation fund and capital expenditure have significant effects on public welfare of regencies and cities in Sumatera in 2015-2017?
- c) Do the locally-generated revenue, general allocation fund, and special allocation fund have significant effects on public welfare of regencies and cities in Sumatera in 2015-2017 by using capital expenditure as an Intervening variable?

### 1.3. Research Objectives

The regional government law by central government obligate local government to manage their own resources and their own people, and expected to carry out development in all fields. In accordance with the formulation of the problem whether the locally-generated revenue, general allocation fund, and special allocation fund have an impact on human development index with capital expenditure as an intervening variable. So the purpose of this study is as follows:

- a) The impact of locally-generated revenue, general allocation fund, and special allocation fund on capital expenditures of regencies and cities in Sumatera in 2015-2017.
- b) The impact of locally-generated revenue, general allocation fund, special allocation fund and capital expenditure on human development index of regencies and cities in Sumatera in 2015-2017.
- c) The impact of locally-generated revenue, general allocation fund, and special allocation fund on public welfare of regencies and cities in Sumatera in 2015-2017 by using capital expenditure as an Intervening variable.

#### **1.4. Research Contribution**

The results of this research is expected to contribute to the academic and practical aspects. For the methodological aspect, this study is expected to enrich previous study by using research data that is longer and more recent than the previous study. In practical terms, this study is expected to be used as a reference that can be used as information relating to government accounting and also its relation to regional government policies in the uses of local government budget. It is expected to provide information aimed at strategic policy making in an effort to optimize the local potential of the region to improve the quality of public services and for regional progress, which will lead to an increase of public welfare

### **1.5. The Scope of Research**

In order that the discussion does not deviate from the focus of the study, researchers provide the following restrictions:

1. The data used are the realization of Locally-Generated Revenue, General Allocation Funds and Special Allocation Funds, Capital Expenditures, and Public Welfare in the 2015-2017 fiscal year.
2. Discussion only covers matters that are explained in the formulation of the problem. Other variables besides research variables that affect one or all of the research variables will not be discussed in this study.

### **1.6. Writing Systematic**

The discussion in this study is described in five chapters with a systematic discussion to make it easier for readers in understanding this research. The first chapter is the introduction, which will discuss the general description that becomes the basis of this research. The second chapter is about the literature review, this chapter discusses the theory that has the relationship with the research problem. This is useful as a rationale for solving problems.

Next is the research method, this third chapter provides an overview of the plan for conducting the research. For the fourth chapter, the result and discussion will discuss the description of the research object and analysis as well as discussion of the research results regarding the impact of locally-generated revenue, general allocation fund, and special allocation

fun on human development index with capital expenditure as an intervening variable. Lastly, on the fifth chapter the conclusions are drawn from the research results, limitations of this research, and also the suggestions for further research.

