

REGIONAL ECONOMIC DISPARITIES IN EASTERN INDONESIA AND DETERMINANTS: COMPARATIVE ANALYSIS OF ORIGIN DISTRICT AND NEW DISTRICT

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Abstract

The objective of this research is to know specifically the difference of regional economic disparity and expansion in districts / cities in eastern Indonesia, as well as determinant of disparity base on development indicators covering economic growth, decentralization policy and quality of human resources. This is a quantitative study using econometric methodology. In this methodology, regression with the dummy variable is used to estimate the data. The results showed differences between origin district and new district, where new district showed higher disparities than origin district. Thus, according to Myrdall Theory, regional economic development disparities are caused by larger backwash effects than spread effects occur in Eastern Indonesia. Another important contribution is that fiscal decentralization plays an important role in reducing regional income disparities in new district, while economic growth and human development index have no significant effect on disparities. In the origin district shows different impacts related to fiscal decentralization in which the policy has a significant positive effect on the disparity, while the human development index has a significant negative effect and economic growth has no significant effect on the disparity.

Keywords: Regional Disparity, Development Indicator, Regional Status

JEL classification: P25, R11

1. Introduction

Diversity is characteristic of Indonesia. The western region of Indonesia has more population density than the eastern region. These geographic differences are in line with significant economic difference. Regional Gross Domestic Product (RGDP) per-capita variation reflects a marked discrepancy. This extreme difference is the result of an evaluation that gave rise to regional autonomy.

The euphoria of regional autonomy in Indonesia has impacted both the community and the government. One of the impacts is the demand for the formation of new local governments (expansion) from existing local government. The expansion focuses on the creation of the district or city government level with new autonomy (decentralization). Decentralization aims to promote a more autonomous form of revenue generation. In other words, the district or city is the real form of autonomy to govern (Mcwilliam, 2011; Seymour and Turner, 2002)

The encouragement of regions in regional profiliration should be able to minimize inequality and improve social welfare (Jamal, 2017). Since 1999 the number of autonomous regions has grown from 319 (covering 26 provinces, 234 districts and 59 cities) to 542 (34 provinces, 415 districts and 93 cities excluding administrative district and cities in the Province of Jakarta) by 2014 (Direktorat Jenderal Otonomi Daerah Kementerian Dalam Negeri Republik Indonesia 2014). Most of the expansions are outside of Java Island especially Eastern Region of Indonesia.

Regional autonomy is expected to be able to manage local fiscal capacity as a determinant of income level in accordance with regional potency. On the other hand regional autonomy

raises the regional ego and competence in promoting growth and development (Mahardiki and Santoso, 2013). Regional readiness is also important to face the regional autonomy policy because for regions with advanced economic structures have high economic growth and the welfare of the community. This is different from developing regions or relatively lagging with low economic growth. Kuncoro (2013) explains that inequality between regions describes the development gap between advanced and lagging regions.

Economic development should reflect the total change of a society and adjust the social system as a whole without ignoring the diversity of individuals and social groups within it, aiming to move toward a better materially and spiritually (Todaro and Smith, 2011). Rustiadi et al (2011) adds that some regional development performance is based on equity, balance and fairness. Regional development has an important aspect of reducing regional inequality and this requires appropriate government policies (Ezcurra and Pascual 2008; Guastella and Timpano 2010).

Fiscal decentralization is a policy to overcome disparities between regions (Fadli 2014). During its implementation the effects of growth and economic progress are stronger in areas with natural resources. This area should be able to manage effectively and efficiently, so that autonomous regions become more independent in financing public services and development. Local governments will be more responsive to local needs and preferences (Zakaria 2013). Increased regional self-sufficiency reflects the region's revenue on the increasing total revenue and the proportion of the transfer decreases.

Fiscal decentralization is related to regional disparities. The relationship between fiscal decentralization and inequality is still contradictory at the level of development. Fiscal decentralization minimizes inequality among regions. Decentralization is able to reduce inequality between regions (Aritenang, 2014; Ezcurra and Pascual, 2008). There are also conflicting results on the relationship of fiscal decentralization with increasing inequality between regions (Arham, 2014; Baransano et al, 2016; Bonet, 2006; Rodriguez-Pose and Ezcurra, 2010).

Inequality between regions is a polemic in a development. Various efforts have been made to address these problems, such as reducing poverty, quality of human resources, income distribution and economic growth (Baransano et al. 2016; Hirobe, 2014; Shobha, 2014). The growth and inequality of inter-regional development is a logical consequence of economic development (Dhyatmika and Atmanti, 2013). Further implications indicate that economic growth is capable of driving the shift in structure, distribution and distribution of income. Many studies discuss economic growth and inequality that show different results. Increased economic growth increases inequality between regions (Fadli 2014; Zakaria 2013). Different results show Antonescu (2012) and Yuliani (2015) that high economic growth is in line with increasing welfare and minimizing inequality between regions. In the Kuznet hypothesis, the early stages of national economic development and the difference in the rate of economic growth result in the inequality of income distribution between regions. In the long run, when economic conditions reach maturity and assuming free market mechanisms and inter-regional factor mobility without a few obstacles and distortions, the different rates of economic growth across regions tend to shrink as the average per capita income level is higher in each region, and ultimately reduce the regional economic disparities (Arsyad 2010).

Moreover human capital becomes an important factor for economic growth. The quality of human resources has an effect on good economic performance. The quality of human resources is reflected in the level of education, health and other indicators, such as the development report published by the United Nations Development Program. The human development index dimension uses new methods of life expectancy as the health aspect, the long-term expectation of school and the duration of education as the educational aspect, and the per capita GDP as the standard of living aspect. The quality of human resources is a proxy of the Human Development Index (HDI). The index has a role that is still ambiguous, because the results of several studies show different results. Increased HDI will be able to reduce inequality between regions (Baransano et al. 2016). On the other hand shows that HDI is the cause of inequality (Dholakia 2003).

Regional economic disparities are decomposed in several sub-groups, sources of income, diverse unit characteristics and heterogeneity that lead to the trend of inequality between regions and between economic sectors of a region (Kuncoro, 2013; Ramos and Coimbra,

2009). Some studies of economic development disparities with different levels of inequality indicators ranging from inequality between countries (Ezcurra and Pascual, 2008; Habanik et al, 2013; Postoiu and Buşega, 2015; Rodriguez-Pose and Ezcurra, 2010) between the provinces of Indonesia (Antonescu, 2012; Bonet, 2006; Islam and Noman, 2015; Wijerathna et al, 2014), interprovinces in Indonesia (Aritenang, 2014; Fadli, 2014; Mahardiki and Santoso, 2013; Zakaria, 2013), between districts / cities in one province outside Java (Baransano et al. 2016; Yuliani 2015; Arham 2014), inter districts / cities within an internal Java province (Abdulah, 2013; Kurniawan and Sugiyanto, 2013), in residency (Cahyono, 2017; Suseno, 2015), inter-district in one district / city (Nugroho 2014). There is also research on pre-crisis and post-crisis disparities (Đoki, Fröhlich, and Bakaric, 2016) and post-expansion inequality (Dhyatmika and Atmanti, 2013).

The emergence of phenomena in development caused by shifts and changes in the paradigm of economic development. Errors in the application of development models cause distortion. The development paradigm shift is done by changing the tendency to measure macro development success to regional and regional approaches. In other words, the optimal utilization of economic potential will increase equity. Convergence in the determination of the region and the center of growth will encourage equal distribution of regional development, so that the development process requires both elements of growth and equity simultaneously. Myrdall's theory explains that in the long-term development process exacerbating disparities caused by circular cumulative causation (O'Hara, 2008; Samudro, Bloch, and Salim, 2015). The condition is triggered by two forces namely the circumstances under which the development of backward areas is tempered by more backwash effects and the circumstances under which the development of underdeveloped regions is driven by more developed areas. Therefore, the deterioration of regional economic disparities due to the impact of spread effects is smaller than backwash effects. The impact of backwash effects of excessive resource exploitation from remote and developing regions (Rustiadi, 2011). It is suspected that the impacts are in the natural areas of eastern Indonesia.

Taking into account previous research that not specified the regional economic disparities with the basic concept of disparity, there is much discussion of regional disparities in Eastern Indonesia that have been done, but there is still a possibility of a gap to discuss regional disparities from various corners of the field. In other words, the purpose of this study is to specifically discuss the identification of differences in economic income disparities in the parent regions and divisions in Eastern Indonesia, as well as the determinants of disparities based on development indicators that include economic growth, decentralization policies and human resource qualities.

2. Research Method

The positivist approach explains that researchers begin causal relationships that are logically derived from causal laws in general theory. All processes lead to empirical testing and legal confirmation (theory) in social life. In general, positivism perspectives use an approach with a deductive direction. Approach with deductive direction can develop and assert a theory that begins with abstract concepts and theoretical relationships and leads to more concrete empirical evidence (Neuman, 2011). Therefore, this research uses positivism perspective with deductive approach.

The type of data used is secondary data with cross section type covering the districts / cities in the Eastern Region of Indonesia in 2016. The data sources of this research are reports, journals and websites such as the Central Bureau of Statistics. This research is a quantitative research using econometric methodology. In this methodology, the analytical tool used is regression, a statistical analysis tool designed to measure the direction and magnitude of the influence of one or more variables on one or more dependent variables (Gujarati and Dawn, 2010; Feshari and Mojtaba, 2017). Regression used in this research is doubled linear regression. The model of multiple linear regression equation is:

$$I_i = \beta_0 + \beta_1 REG_i + \beta_2 FD_i + \beta_3 HDI_i + \varepsilon_i \quad (1)$$

In the formula, i refers to districts / cities; β are parameters (constants and coefficients); REG is an economic growth that shows the development of activities in an economy where the production of goods and services is increasing used for the welfare of society; FD is Fiscal

Decentralization which shows the ratio of local revenue to total revenue; HDI is a human development index. I is a regional disparity calculated using the J. Bonet index.

The revenue disparity between regions is measured by Jaime Bonet (I) Index. The index measures the relative per-capita income disparity. The measurement of the Jaime Bonet index is based on the perfect balance that occurs when per-capita districts / cities are equal to the provincial average in certain regions and years. The Jaime Bonet Index calculation formula is:

$$I_i = \left| \frac{PCPDB_i}{PCPDBNAL_i} - 1 \right| \quad (2)$$

PCPDB_i refers to Gross Regional Domestic Product per capita District / City and PDBNAL_i is the Province Gross Domestic Product per capita. Gross Regional Domestic Product per capita is calculated based on Gross Regional Domestic Product divided by population. *i* denote County / City and *t* show years of observation.

To know the difference of disparity between regions and the magnitude of the influence of each independent variable in the regression model in the parent region and the division with the dummy variable. According to Gujarati and Dawn (2010), the dummy variable is a tool for classifying data by dividing the sample into subgroups based on qualities or attributes and explicitly enabling to operate individual regressions for each subgroup (flexible dummy variable techniques). To avoid dummy variable traps, the number of dummy variables is $k-1 = 2-1 = 1$ (one dummy variable). Application of dummy variables on the regression equation:

$$I_i = \beta_0 + \beta_1 REG_i + \beta_2 FD_i + \beta_3 HDI_i + \beta_4 d1_i + \beta_5 d1REG_i + \beta_6 d1FD_i + \beta_7 d1HDI_i + v_i \quad (3)$$

The formula can be explained that *d1* refers to dummy variables, worth 1 for the post new district of Law 32 Year 2004 and 0 for the origin district. Please note that mapping related to expansion areas is indicated by local laws based on the establishment of autonomous regions in Indonesia from the publication of the Directorate General of Regional Autonomy of the Ministry of Home Affairs of the Republic of Indonesia.

3. Result and Discussion

Regression analysis with dummy variables identifies differences in regional income regional economic disparities and expansion in Eastern Indonesia and the determinants of the objectives in this study. Table 1 shows the regression results with dummy variables.

Table 1. Regression Result

Variable	Coefficient	t-Stat	Prob.t
C	0,7286	3,0662	0,0024***
D1	0,8358	2,1838	0,0300**
REG	0,0009	0,1625	0,8710
FD	0,0091	1,8080	0,0720*
HDI	-0,0074	-1,9509	0,0523*
D1*REG	-0,0307	-1,2958	0,1964
D1*FD	-0,0412	-2,4899	0,0135**
D1*HDI	-0,0080	-1,3988	0,1633
R-squared	0,1382	F-stat	5,0183
DW-stat	1,7534	Prob(F-stat)	0,0000***

Note: * significance of $\alpha(10\%)$; ** significance of $\alpha(5\%)$; *** significance of $\alpha(1\%)$

Based on the regression result, estimation model in this research are:

$$I_i = 0,7286 + 0,0009REG_i + 0,0091FD_i - 0,0074HDI_i + 0,8358d1_i - 0,0307d1REG_i - 0,0412d1FD_i - 0,0080d1HDI_i$$

Regression results for the simultaneous test show that the model used is exist because the prob. F statistics of $0,0000 < \alpha (0,01)$. Simultaneously, some variables, like variable of economic growth, fiscal decentralization and human development index have a significant effect on economic disparity in the origin district and the new district in eastern Indonesia. In addition, the determinant coefficient (R-Square) interpreted variance of disparity able to explain the variable of economic growth, fiscal decentralization and human development index 13,82 percent, while the rest explained other factors not included in research model.

Please note that the number of observations in this study covers all districts / cities in Eastern Indonesia except Kolaka district, Mimika district, Teluk Bintuni, West Sumbawa

district and Kupang City. The district / city is not included because they have unique characteristics that look very different from other observations. Here comes the form of extreme values for either a single variable or a combination (outlier data). The identification of data outliers in this study is due to the extreme value that is too high and too low on the variable income per capita that shows too big gap. This causes an abnormal residual distribution. According Ghozali (2016) philosophically should the data outlier maintained if able to represent the population but if unable to describe the observations in the study, it should be discarded. If it is maintained it will be the cause of abnormal distribution. Without the inclusion of outlier data expected to fulfill normal distribution. In addition, this study has met other supporting tests such as model specifications are correct and there is no problem of autocorrelation and homoskedastisity.

Table 1 of the regression results shows the disparity of economic income in the origin district and the new district in Eastern Indonesia. This is indicated by the significance of dummy variable (D1) that is statistical prob.t 0,0300 is smaller than α (0,05). Disparities in economic revenues in new district were 0,8358 higher than origin district in Eastern Indonesia. This indicates that the new district, especially Eastern Indonesia, takes time in the long term to adjust internal conditions, administratively, socioeconomic, political and other conditions. This is reversed with origin district that have long been able to control the development disparities that emerge in the area.

Regression results in the origin district and new district show that economic growth is not too strong to affect the disparity of economic income. This suggests that in the very short period of time, economic growth has not shown an impact in overcoming or exacerbating disparities in both regions. There are indications that economic growth is capable of reducing disparities in new district, but vice versa in origin district to diverge. This result is in line with research conducted by Jamal (2017) with the result that economic growth does not have a strong influence on the disparity of economic development.

The same regression result table shows different results related to the effect of fiscal decentralization on disparities in origin district and new district in Eastern Indonesia. Fiscal decentralization has a significant positive effect on the disparity of economic income in the origin district. This is indicated by fiscal decentralization statistical probabilities of 0,0720 less than α (0,10). Based on the value of the regression coefficient, fiscal decentralization risen by one percent then the economic income disparity increased by 0.0091. This result is in line with Arham's (2014) research indicating that fiscal decentralization is increasing so that disparities will increase. In general, income levels have increased since the implementation of decentralization, but the development and increase in regional income varies with relatively richer origin district developing faster than relatively poor origin district. Wealth of the region, especially Eastern Indonesia because of the large potential of natural resources and investment is great. The resource potential of course varies in each region. The richer origin districts have per capita fiscal resources including local revenue from higher revenue-sharing taxes than the relatively poor origin district. Wealthy origin district are able to receive greater benefits from economic recovery programs in addressing disparities than poor origin district.

In the new district, fiscal decentralization has a significant negative effect on economic income disparities. This is indicated by a fiscal decentralization statistical prob.t of 0,0135 which is smaller than α (0,05). Based on the value of the regression coefficient indicates that fiscal decentralization increases by one percent then the economic income disparity decreases by 0,0412. In other words, fiscal decentralization increases then the disparities will decrease. This result is in line with Ezcurra (2008) and Prodromidis (2012) research but the measurement aspects of fiscal decentralization and disparity are different. Fiscal decentralization as measured by the ratio of local revenue to total revenues is able to show its existence in financing local needs and preferences of new district. Increased local revenue reflects the level of regional autonomy. The greater the region's original revenue shows the dependence on the central government is reduced and fiscal decentralization is able to be implemented expansion areas. The existence of decentralization policy, the regions will be more independent in regulating the area. More autonomous regions in the presence of fiscal decentralization can bring substantial economic efficiency in the allocation of resources across the public sector. Fiscal decentralization has been able to improve economic efficiency since local governments are closer to local people than central government so that local

governments will be more responsive to local needs and preferences. Governments and communities are expected to simulate local resources to create high economic development in their respective regions when both reach autonomous levels. Thus, the fiscal decentralization policy shows success in reducing the disparities of regional economic revenues of new district.

The Differences in HDI in each region make this index as one of the factors that affect the income disparity between regions, as happened in the origin district in eastern Indonesia. The new indicator in the calculation of human development index was able to represent the central role of this index in reducing regional economic disparity. This is because the quality of human resources is good cause the economic performance will also be better. In other words, the higher the human development index will be the higher the level of population productivity which then push the level of income becomes higher. Based on the results, the regression shows that the human development index has a significant negative effect on income disparities between regions in origin district. The result is indicated by a statistical prob.t value of 0,0523 which is smaller than α (0,05). In other words, if the index of human development increases then the disparity of economic income also increases. The results are in line with research by Baransano et al (2016) but for aspects of different dimensions of human development index and the different aspects of disparity. The importance of human development does not show a significant role in reducing disparities in the new district of eastern Indonesia. However, it indicates an important role for human development in reducing disparities.

4. Conslusions

The research results show the differences between the origin district and the new district in Eastern Indonesia. Disparities in new district are higher than origin district. Thus, according to Myrdall Theory, the deterioration of regional economic development disparities is caused by backwash effects greater than in spread effects. This happened in Eastern Indonesia. In origin district, the human development index has significant negative effect and fiscal decentralization has a significant positive effect on disparity, while economic growth has no significant effect on disparity. In new district, the human development index and economic growth have no significant effect on disparity, whereas fiscal decentralization has a significant negative effect on disparity. In expansion areas are able to capture the phenomenon in the implementation of fiscal decentralization policy to reduce disparity between regions. In contrast to what happens to the origin district that cause wider disparities. However, in the origin district, improving the quality of human resources has a role to reduce disparity between regions.

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