Impact of Government Expenditure, Human Capital and Regional Economic Development Performance on People Welfare in Bali Province, Indonesia

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Abstract

Many countries in the world implement the delegation of authority or decentralization of governance in order to maximize the function of public services and improve social welfare. Similarly, Indonesia has implemented decentralization since 2001. Bali is one of the province in Indonesia with HDI (2012) ranked 14th out of 33 provinces, but it does not indicate the condition of all areas evenly. This research, focuses on fiscal decentralization, aims to analyze the impact of government spending on human capital; the impact of government spending and human capital on the performance of regional economic development; and the impact of government spending, human capital and regional economic development performance toward the welfare of the people in the province of Bali. The data were analyzed by using PLS, and the processed data are the data panel of nine districts / municipalities in Bali Province for 12 years since the decentralization. The results show that government spending, human capital, and the performance of regional economic development, both directly and indirectly have positive and significant impact on the welfare of the community. Given the importance of the mediating role of human capital, the government is advised to focus government spending on areas directly related to efforts to improve human capital.

Keywords: government expenditure, human capital, regional economic development performance, people welfare

1. Introduction

Delegation of authority and responsibility for management of government from central government to the local government, called decentralization, has actually been in place for decades in many countries. The purpose is to delegate authority to maximize the functions of public service (Ahmad, et al, 2005). Thompson (2004) states that there are at least 14 (fourteen) motivation behind the decentralization in various countries, namely: 1) political and economic transformation, 2) a political crisis due to ethnic conflict, 3) political crisis due to regional conflicts, 4) enhancing participation, 5) interest in EU Accession, 6) political maneuvering, 7) fiscal crisis, 8) improving service delivery, 9) to centralize, 10) shifting deficits downwards, 11) shifting responsibility for unpopular adjustment programs, 12) prevent return to autocracy, 13) preservation of communist rule, and 14) globalization and information revolution.

Indonesia began to implement decentralization in 2001. The implementation of decentralization in Indonesia aims at achieving political and economic objectives. The political objective is to realize the democratization of local government through direct accountability of the heads of regions to their constituents in the area, while the economic objective is to improve the welfare of the people through equitable provision of public services in the area as well as to shorten the span between public service providers and local communities (UNDP, 2009).

The welfare of the people can be achieved through the accumulation of resources owned by a country, which consists of human capital, physical capital and natural capital (Thomas et al., 2000). The three capital is interacted well in the development process to achieve the welfare of people, and human capital as one of the capital in the public welfare can be formed through improving the quality of basic services, especially education and health services. Therefore, decentralization or devolution to local governments is very important in accelerating the improvement of people welfare.

Various studies show that government spending on education and health has positive and significant direct impact to the formation of human capital (Baldacci et. Al, 2004), (Owoeye and Adenuga, 2005), (Widodo, Waridin, and Maria, 2011), and Sjafii (2009) confirms that the investments allocated to improving the quality of human capital, the results are not visible in a short period.

In addition to providing indirect influence to economic growth through human capital formation, government spending on education and health is also directly affect the performance improvement of regional economic development. Various studies show that government expenditures for education and health give a

positive and significant impact on growth (Baldacci et. Al, 2004), government spending is targeted both for health, education and infrastructure has a positive impact on growth (Gerson, 1998), and two of the six categories of fiscal namely: expenditure on education and health turned out to provide significant long-term effect on growth (Singh and Weber, 1997).

This study took place in all districts / cities in the province of Bali, where the achievements of the people welfare of Bali Province indicated by the HDI in 2012 was ranked 14th nationally, an achievement that was encouraging and is formed of HDI districts / municipalities in Bali Province. However these achievements are not the same in all districts / municipalities in Bali Province. Achievement of HDI in some districts / cities exceed the achievement of Bali Province, while other regions is below it. It must not be separated from the role of district / city in the formation of the HDI in the region. One of local government's role in the formation of the HDI is through budget allocations for expenditure in the field of education, health, public works, transportation sector, the environmental field, the field of peace and public order, social, economics and public administration fields. For this reason this study are located in districts / municipalities in Bali Province.

Regions with high budget will certainly increase the expenditure, and contrary, regions with small budget will have limitations in expenditures. This condition also occurs in districts / municipalities in Bali Province, where areas with high income, will allocate high expenditure. Government spending will be used for the entire community in each district / city, and is expected that it can benefit the whole community in the region. The government spending per capita of each district / city can be seen in Table 1

Table 1. Government Spending Per Capita Regency / City in the Province of Bali Years 2005-2012 (In Thousand)

Districts / City	Government Speending Per Capita Per Year							
	2005	2006	2007	2008	2009	2010	2011	2012
Jembrana	1.090,94	1.311,85	1.481,43	1.659,79	1.770,73	1.819,13	2.011,22	2.415,86
Tabanan	787,68	1.153,91	1.243,59	1.547,43	1.661,68	1.886,81	1.805,75	2.411,27
Badung	1.669,39	1.725,09	2.281,84	3.245,81	3.679,17	3.356,22	4.533,30	5.556,34
Gianyar	1.057,87	1.123,78	1.420,36	1.594,13	1.802,26	1.886,80	2.126,61	2.196,73
Klungkung	1.170,35	1.667,60	2.044,98	2.286,65	2.441,17	2.385,63	3.045,08	3.137,79
Bangli	781,92	1.314,82	1.742,06	1.916,21	1.998,10	2.181,86	2.832,97	2.731,64
Karangasem	671,94	970,36	1.042,09	1.401,51	1.521,22	1.500,50	1.602,43	2.062,30
Buleleng	560,71	805,69	993,09	1.099,86	1.182,50	1.263,41	1.648,20	1.619,77
Denpasar	768,96	1.119,24	1.216,79	1.387,70	1.551,62	1.793,64	2.227,40	2.457,55

Sourse : BPS Province of Bali, 2013

Most economists use economic growth as one of the indicators of people's welfare. Economic growth, as an indicator of economic development, is expected to create employment opportunities which can certainly accommodate more workers and minimize the unemployment rate. With the increasing number of people who obtain a job will result in more people with income to meet their living expenses. It is expected to reduce the number of poor people. The above conditions are proved in the province of Bali, which can be seen in Figure 1.

Figure 1. Economic Growth, Unemployment and Poverty in Bali Year 2001-2012
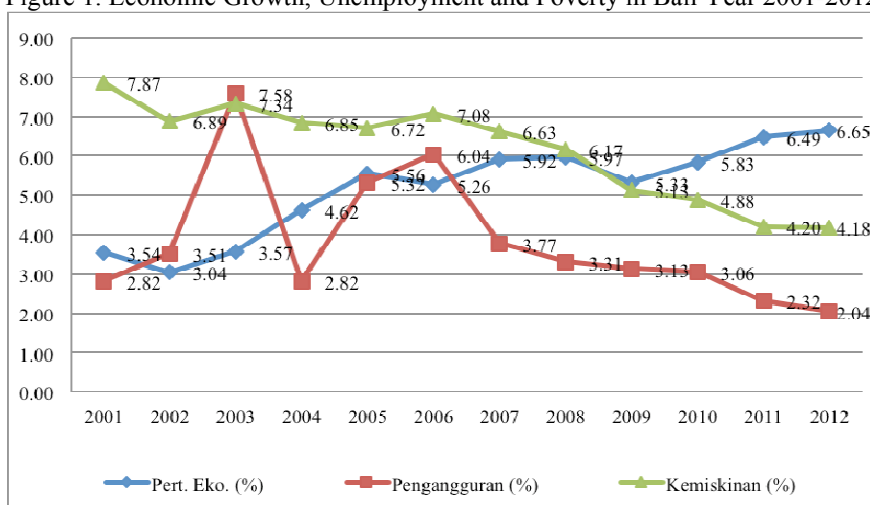
Source : BPS Province of Bali, 2013

Previous studies show different conclusions about the relationship of government spending, human capital, and the performance of regional economic development for the welfare of the people. It is not consistent and it can be positive or negative. The results and evidence is different in a country or a region. The nature of the impact of government spending depends on the condition of the country. Therefore, this study aims to: (1)

analyze the impact of government spending on human capital; (2) analyze the impact of government spending and human capital to the performance of regional economic development; and (3) analyze the impact of government spending, human capital and regional economic development performance to the welfare of the community.

2. Theoretical Review
2.1 The Concept of People Welfare
Thomas, et al (2000) in his book entitled The Quality of Growth wrote that the welfare of the people can be achieved through the accumulation of resources owned by a country. More specifically Stiglitz (2011) states that to define welfare, multidimensional formula should be used. These dimensions include the standard of living material (income, consumption and wealth), health, education, individual activities including work, political voice and governance, relationships and kinship social, environmental (the present condition and future) and discomfort, either the economic and physical. All of these dimensions indicate the quality of life and to measure it, objective and subjective data is needed.

Modest Scheme (Figure 2) of resources owned by the state namely human capital, physical capital and natural capital which are integrated well in the development process will produce the desired economic growth. The three capitals contribute through economic growth, and is a direct component to achieve the welfare of the community. Investment to these three components will contribute to technological progress and the growth of Total Factor Productivity (TFP), which will boost economic growth.

Figure 2: The Framework of Wellfare in Development
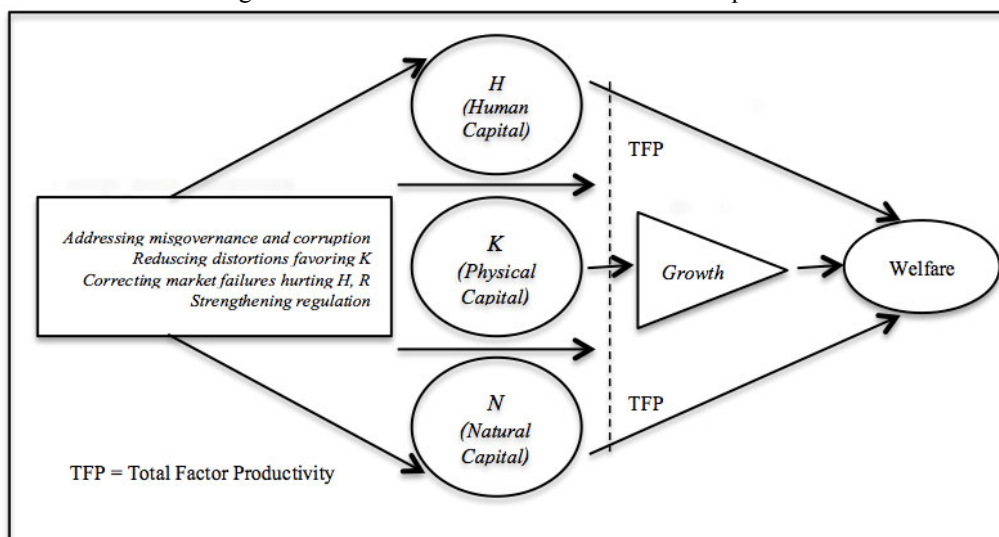
Source: Thomas *et. al* (2000, XVII).

Saharudin (2008) measures the level of social welfare by using the Human Development Index (HDI) with indicators: per capita income, life expectancy and enrollment.

2.2 Theory of Economic Development
Economic development is a multidimensional process that includes not only economic growth but also changing in structure, attitude, and institution, where the real result is indicated by a decrease in unequal distribution of income, reduced poverty, and shrinking unemployment rate (Simanjuntak and Muklis, 2012). While economic growth is simply defined as an increase in aggregate output or an increase in real incomes, in which the increase is usually calculated per capita or over a long period as a result of increased use of inputs.

In addition to economic growth, in observing economic development, need also to be reviewed in terms of unemployment and poverty. Unemployment by BPS (2008) is a condition where a person resident in the working age who: (1) do not work; (2) are looking for work; or (3) are preparing a business, or (4) are not looking for work because they feel it is impossible to get a job; or (5), get a job but have not started working. Kuncoro (1997) argues that poverty is the inability to meet the minimum standard of living.

2.3 The concept of Human Capital
Mankiw (2006) defines human capital as a term used by economists to refer to the acquired knowledge and skills of workers through education, training and experience. Furthermore Stroombergen, Rose and Nana (2002) state that there is a merge of three (3) cost flow that establish a country's human capital, namely: (1) the costs incurred by the individual and family; (2) the costs incurred by companies or employers who hire; and (3) the costs

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incurred by the government, both central and local government, which is used to run the education system and the health system for the people. The third stream of such fees merged which in turn can provide benefits to the formation of human capital in the future.

2.4 Theory of Government Spending

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2.6 Theory of Government Expenditure Pengeluaran Pemerintah

Mangkusoebroto (2001) mentions that theories about government spending can be classified into three categories, namely:
1. The development model of the development of government spending. The model was developed by Rostow and Musgrave linking the development of government spending by stages of economic development. The role of government during these stages is still great.
2. The Wagner Law regarding the development activities of the government. Wagner expresses his opinion in the form of a law, but in his view it is not explained what is meant by the growth of government expenditure and GNP, whether in terms of growth neither in relative nor in absolute terms.
3. Peacock and Wiseman theory explains that economic development lead to tax increase even if the tax rate doeas not change; and increasing tax revenues causes government spending also to increase. Therefore, under normal circumstances, rising GNP causes government revenues to raise, and so does government spending becomes larger. In contrast to Wagner's view, the development of government spending of Peacock and Wiseman version is not in a form of a line, but of a ladder.

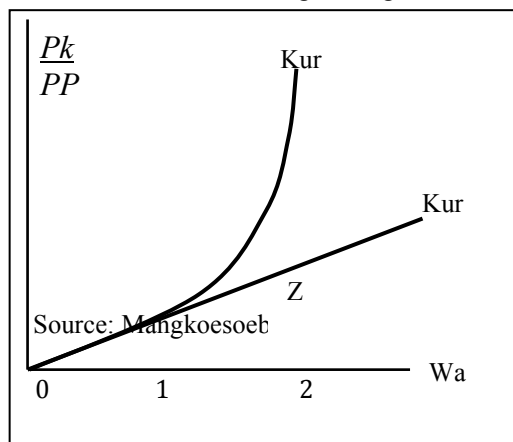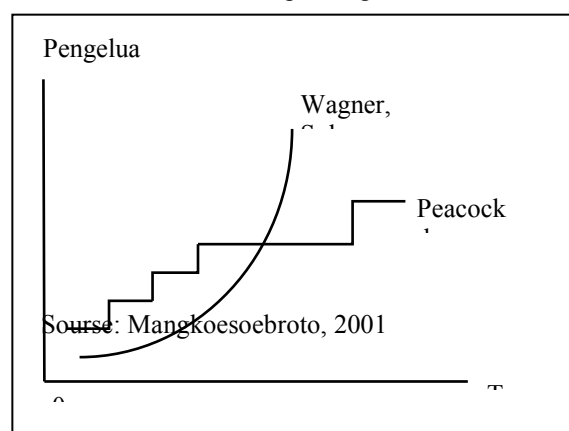Figure 3. Growth of Government Spending According to Wagner

Figure 4. Curve of Developments of Government Spending

3. Research Methods

Based on the background of the problems and the review of related literature, the present research conceptual framework can be seen in Figure 5.

This research is an explanatory research that takes place in the districts / cities in the province of Bali. This study uses panel data which are a combination of cross section data which consist of 9 districts / cities and time series period of 2001 up to 2012, or 12 years of observation. The analysis used in this research is descriptive analysis and quantitative analysis method of Partial Least Square (PLS).

Figure 5. Conceptual Framework
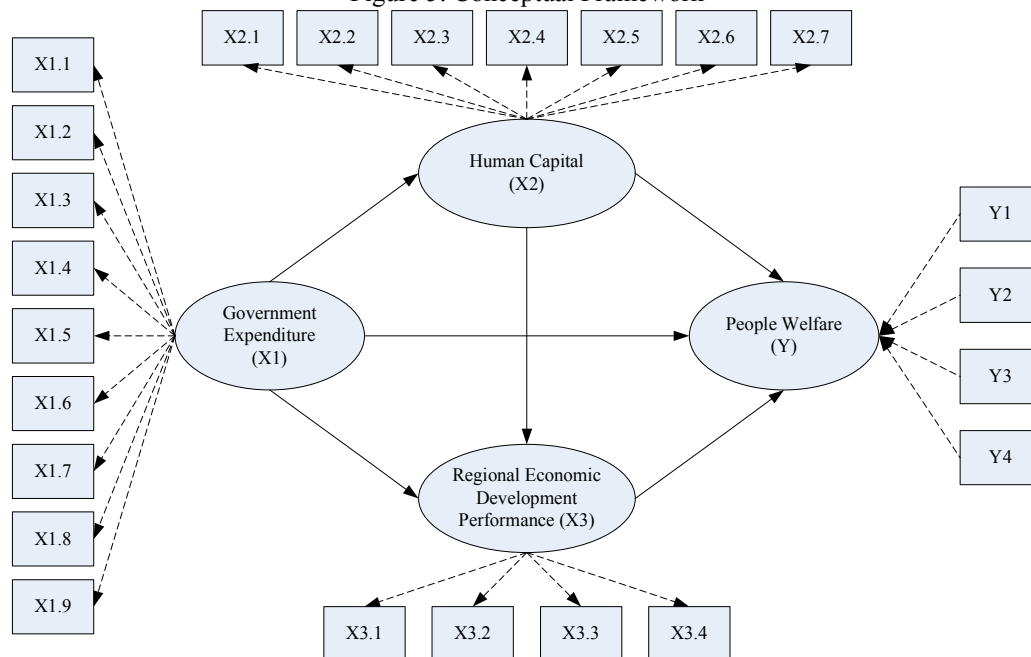
4. Data Analysis and Discussion

4.1 Data Analysis with PLS

In analysing data with PLS, there are several steps that must be done. The first is to test the outer model that includes evaluation of convergent validity and discriminant validity. The test results in convergent validity as shown in Appendix 1, while the discriminant validity is shown in Appendix 2.

After testing the outer model, then inner model test is conducted against the estimated model and it shows that the level of validity and reliability in this research is good. Test of inner model is testing among the variables by looking at the value of R-Square and Q2 or Stone Geiser Q Square Test.

Processed R-Square as Table 2.

Tabel 2. The value of R Square for Endogenous Construct Variables

Construct Variable	R Square (R^2)	Remark
Human Capital (X2)	0,090	Weak
Performance of Regional Economic Development (X3)	0,776	Good
People Welfare (Y)	0,871	Good

Using R2 in the Table 5.34, the Q2 or Stone Geiser Q square test can be calculated as follow.

$$Q^2 = 1 - \{(1-0,090)(1-0,776)(1-0,871)\}$$
$$= 1 - \{(0,910)(0,224)(0,129)\}$$
$$= 0,973$$

The result of the calculation of Q2 is 0.973, which means that it has a high predictive prevelance, so that the models can be used to predict. The readings of 0.973 means that the people welfare variation of 97.3 percent are able to be explained by variations in government expenditure variables, human capital, and the performance of local economic development, while the remaining 2.7 percent is explained by other variables outside the model.

The next steps are testing direct impact, indirect impact and the total impact of variables. The test results are shown in Table 3 and Table 4.

Table 3. Path Coefficients Value

Construct			Original Sample	Standard Error	t-Value
Government Expenditure (X1)	->	Human Capital (X2)	0,300	0,080	3,756*
Government Expenditure (X1)	->	Performance of Regional Economic Development (X3)	0,527	0,046	11,400*
Government Expenditure (X1)	->	People Welfare (Y)	0,034	0,070	0,485
Human Capital (X2)	->	Performance of Regional Economic Development (X3)	0,565	0,043	13,075*
Human Capital (X2)	->	People Welfare (Y)	0,759	0,090	n. Inde
Performance of Regional Economic Development (X3)	->	People Welfare (Y)	0,206	0,101	2,033*

Note : *) Significant at α = 5%

Tabel 4. The value of Indirect Effects

Construct			Original Sample	Standard Error	t-Value	Note
Government Expenditure (X1)	->	People Welfare (Y)	0,372	0,087	4,299*	Full Mediation
Government Expenditure (X1)	->	Performance of Regional Economic Development (X3)	0,170	0,044	3,834*	Full Mediation
Human Capital (X2)	->	People Welfare (Y)	0,117	0,057	2,059*	Partial Mediation

Note. : *) Significant at α = 5%

4.2 Impact of Government Spending on Human Capital
The data analysis shows that government spending has a positive and significant impact on human capital. This is indicated by the path coefficients of 0.301 and the level of probability is 0,000. This means that increasing government spending allocated to government spending on education, health, public works, transportation sector, the environmental field, the field of peace and public order, social, economics and field general government will improve human capital as indicated by the workforce in sectors A, employment in the sector S, mid-educated work force, and the School Enrollment (APS) 16 to 18 years.

4.3 Impact of Government Expenditure and Human Capital Performance on Local Economic Development
During the period of 2001-2012, government spending had significant positive impact on the performance of

economic development of districts / municipalities in Bali Province. This suggests an unidirectional relationship between government expenditure and performance of local economic development, so that the increase in government spending in all areas will improve the performance of local economic development in their respective districts / municipalities in Bali Province.

The results shows that government spending impact the performance of local economic development, and government spending indirectly also has positive and significant impact on the performance of local economic development through human capital in the province of Bali for the period of 2001 - 2012. This means that the government spending positively and significantly impact the performance of local economic development, directly or indirectly through human capital.

4.4 The impact of Government Expenditure, Human Capital and Local Economic Development Performance on People Welfare

The results of this study indicate that districts / city government spending in Bali in the period of 2001-2012 do not impact the welfare of the community. In this study, the nine indicators of government expenditure which consists of: government spending in education, health, public works, transportation sector, the environmental field, the field of peace and public order, social, economics and the field of general government, has no impact on the people welfare which comprises of some indicators namely: life expectancy, literacy rates, average length of school, and spending per capita. This shows that government spending has not been able to directly improve the welfare of the people in the province of Bali.

Indirectly, government spending significantly and positively impact the welfare of the people in Bali Province in the period of 2001-2012, through human capital and regional economic development performance. This means that the indirect impact of government spending on the welfare of the people can be achieved, since government spending directly impacts human capital and also directly impacts the performance of local economic development, even though government spending does not directly impact the welfare of the people in the district / city of Bali province.

Further, indirectly human capital positively and significantly impacts the welfare of the people through the performance of regional economic development in the province of Bali for the period of 2001 - 2012. This means that when the human capital increases, then the public welfare will experience increased performance that can be achieved through regional economic development. The impact of human capital on the welfare of the people through local economic development performance is 11.7 percent and the rest is explained by other variables outside the model. In addition to the indirect impact, human capital also positively and significantly has direct impact on the welfare of the people, where the direct impact is equal to 75.9 percent and the rest is influenced by other variables outside the model.

5. Conclusions and Implications

Based on the analysis of data, it can be concluded that government spending has significant positive effect on the human capital in the province of Bali. Furthermore, government spending and human capital have positive and significant direct impact on the performance of regional economic development. While indirectly, government spending has also positive and significant effect on the performance of regional economic development through human capital.

The third conclusions is that government spending, human capital, and performance of local economic development have significant positive impact on the welfare of the people in the province of Bali. Where government spending has also positive and significant impact on the welfare of the people through human capital and regional economic development performance. Similarly, human capital also has positive and significant impact on the welfare of the people through local economic development performance.

Based on the research conclusions, district / city governments in Bali are advised to focus more government spending on those areas for the benefit of human capital investment, including the improvement of public goods and services. business, or (4) are not looking for work because they feel it is impossible to get a job; or (5), get a job but have not started working. Kuncoro (1997) argues that poverty is the inability to meet the minimum standard of living.

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Appendix 1
Outer Loading

Variable Relation	Original Sample (O)	Standard Error (STERR)	T –Value (|O/STERR|)
X1.1 ← Government Expenditure	0,757	0,074	10,120*
X1.2 ← Government Expenditure	0,760	0,074	10,199*
X1.3 ← Government Expenditure	0,670	0,102	6,549*
X1.4 ← Government Expenditure	0,678	0,071	9,459*
X1.5 ← Government Expenditure	0,781	0,039	19,890*
X1.6 ← Government Expenditure	0,556	0,085	6,543*
X1.7 ← Government Expenditure	0,756	0,043	17,268*
X1.8 ← Government Expenditure	0,667	0,083	8,000*
X1.9 ← Government Expenditure	0,566	0,097	5,804*
X2.1 ← Human Capital	-0,951	0,471	2,018*
X2.2 ← Human Capital	0,080	0,081	0,992
X2.3 ← Human Capital	0,930	0,463	2,005*
X2.4 ← Human Capital	-0,722	0,370	1,947
X2.5 ← Human Capital	-0,874	0,439	1.991
X2.6 ← Human Capital	0,962	0,477	2,016*
X2.7 ← Human Capital	0,823	0,404	2,034*
X3.1 ← Regional Economic Development Performance	0,850	0,032	26,534*
X3.2 ← Regional Economic Development Performance	0,893	0,021	41,728*
X3.3 ← Regional Economic Development Performance	0,208	0,130	1,594
X3.4 ← Regional Economic Development Performance	0,860	0,017	48,126*
Y1 → People Welfare	0,556	0,059	9,373*
Y2 → People Welfare	0,788	0,035	22,291*
Y3 → People Welfare	0,984	0,011	83,244*
Y4 → People Welfare	0,279	0,131	2,132*

Appendix 2
Cross Loading

Construct	Indicator	GE (X1)	HC (X2)	REDP (X3)	PW (Y)
Government Expenditure (X₁)	X1.1	**0.760**	0.102	0.442	0.123
	X1.2	**0.763**	-0.035	0.398	0.077
	X1.3	**0.671**	0.095	0.461	0.128
	X1.4	**0.676**	0.191	0.337	0.272
	X1.5	**0.778**	0.573	0.717	0.651
	X1.6	**0.557**	-0.009	0.265	0.108
	X1.7	**0.759**	0.187	0.601	0.289
	X1.8	**0.670**	-0.106	0.240	-0.064
	X1.9	**0.571**	-0.031	0.291	0.052
Human Capital (X₂)	X2.1	-0.225	**-0.958**	-0.687	-0.890
	X2.3	0.250	**0.931**	0.694	0.910
	X2.6	0.315	**0.954**	0.674	0.871
	X2.7	0.328	**0.834**	0.607	0.695
Regional Economic Development Performance (X₃)	X3.1	0.597	0.540	**0.851**	0.612
	X3.2	0.740	0.599	**0.895**	0.626
	X3.4	0.485	0.733	**0.858**	0.781
People Welfare (Y)	Y1	0.185	0.518	0.419	**0.557**
	Y2	0.236	0.737	0.615	**0.797**
	Y3	0.343	0.915	0.742	**0.986**
	Y4	**0.699**	0.147	0.592	0.295