

The Effect of Fiscal Decentralization on Poverty Reduction: Evidence from Indonesia

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Abstract

Indonesia had implemented a decentralization policy for more than 20 years. Until now, the purpose of decentralization to equalize the pace of economic development was still ongoing yet many issues still occurred especially high poverty and low Human Development Index (HDI) in eastern parts of Indonesia. This research wants to see the impact of decentralization policy for poverty reduction in Indonesia which is indicated by reduction of poverty rate and increase in HDI. Using OLS regression of panel data of 491 municipalities and regencies in Indonesia for 2011-2020, the results shows that fiscal decentralization have a negative impact for HDI and expected years of life respectively 0.016 point and 0.012 year but have a positive impact to per capita income by IDR 12.75 thousand. After conducting two stages least squares (2SLS), using election as an instrumental variable, only expected years of life have negative and significant results by 0.057 year. Political budget cycle indicates the results of 2SLS as the first stage shows that elections have negative relation with fiscal independence. As conflict still happen in Indonesia around the election process, expected years of life also influenced by this process but not give direct impact to per capita spending and HDI which need longer intervention than election process which held only once in five years.