Analysis of Institutions and Convergence in Decentralizing Indonesia

Ariesy Tri Mauleny[1*], Nidya Waras Sayekti[1], Sony Hendra Permana[1], Indana Fiersy Tsabita Arsil[2]

[1]*Center for Research of the Parliamentary Expertise Agency of the Indonesian House of Representatives, 10270, Indonesia*
[2]*Student of State Administration Department, Faculty of Administrative Sciences, University od Indonesia, Indonesia*
Corresponding author's email: ariesy.mauleny@dpr.go.id

ABSTRACT

Efforts to understand disparities in growth achievements among the regions are still being made. The concentration no longer lies in the physical capital, human capital, and population growth, yet it lies in how productivity is affected by institutions and social infrastructures. This study was aimed at investigating the influence of institutions, governance, regulations, and corruption on the income growth and speed of convergence. The estimation methods that we employed were cross-section, static panel, and static-dynamic on 491 data of regencies/cities in Indonesia from 2009 to 2015. This study has indicated that regional government institutions as entities that legally monopolize power in the constitutional system may encourage or distort the growth and speed of convergence, besides physical, human and population growth capitals. Institutions' capability of encouraging or reducing depends on fiscal policies, governance effectiveness (politicians and bureaucrats), the quality of regional regulations produced, and efforts made to eradicate corruption practices. Improper relations and interactions may breed a social conflict and inefficiency resulting in a weak system of incentives in the society and the productivity article.

Keywords: Customize Institutions; Convergence; Regional Economic Growth

1. INTRODUCTION

For the past two decades, efforts to understand disparities in growth achievement among the regions have still been rooted in neoclassical and endogen theories, both theoretically and empirically. The disparities derive from the capability of accumulating capitals and the experience of growths in each country [1]. The theoretical approach puts endogeneity on the analysis focus, while the empirical approach rests on Solow's augmented model. However, the interactions between them have not shown any good attachment.

Disparities in the growth experience have been elaborated in many cross-national variations in the residual level presented by Solow. The next analysis is introducing institutions and policies as variables that should be accounted for. Disparities in output per worker is determined by the capability of accumulating capital and productivity encouraged by the disparities in institutions and policies. Institutions and policies as social infrastructures determining the economy inside of them social infrastructures, institutions, and policies becomes the focus of extending growth for the past decade [2]. Institution as a rule made to form political, social, and economic interactions both formally and informally and to determine intensive structures in the society [3], [6]. Agreeing with North, Acemoglu et al., define an institution as a set of rules of the game required in every economic, political, and social interaction.

However, after almost 20 years of treading the democratic and decentralization era, the autonomy objective of eradicating gaps and creating an equitable development has not fully taken place yet. Indonesia is still facing many problems such as governance distorted by corruption practices from both bureaucrats and politicians and troublesome and revoked regional government regulations. Accordingly, where is this study located amidst various problems and theoretical and empirical developments mentioned above? This study was essentially aimed at analysing how a growth convergence occurs in Indonesia and investigating

whether institutions affect the growth and speed of convergence?

2. METHOD

As far as we were concerned, specific studies on Indonesia still focused on whether absolute and conditional convergences had occurred or not. There were no studies that had included the extended model variables employed in this study. Most of the previous studies had already used the provincial data, while this study used the data of 491 regencies/cities. This study focused on understanding how institutions/social infrastructure affected growth and the speed of convergence. Various variables such as the regional government's governance, the establishment or revocation of regional regulations, corruption was employed to explain institutions in Indonesia. So far, most of the studies had defined institutions separately in different contexts that employed government effectiveness as well as regulation quality [7]. Meanwhile, Djangkov only focused on the regulations in relation to economic growth [8].

The study focused on the convergence, institution, and per capita income growth of regencies/cities in Indonesia to be able to give a comprehensive picture on institutions in Indonesia and elaborate the stages of the study conducted. Hence the empirical specification employed in this study has been seen in Figure 1:

$$\ln[y_t] - \ln[y_0] = a + (1 - e^{-\lambda t}) \ln[y_0] + (1 - e^{-\lambda t}) \frac{\alpha}{1 - \alpha - \beta} \ln[s_k] + (1 - e^{-\lambda t}) \frac{\beta}{1 - \alpha - \beta} \ln[s_h]$$

$$- (1 - e^{-\lambda t}) \frac{\alpha + \beta}{1 - \alpha - \beta} \ln(n + g + \delta) + (1 - \alpha - \beta) \ln \sum_j^n \psi_j \, V_j(t)$$

$$+ (1 - \alpha - \beta) \ln \sum_k^m \varphi_k \, W_k(t) + (1 - \alpha - \beta) \ln \sum_l^o \omega_l \, Z_l(t) + \varepsilon$$

Figure 1 Equations

Where:

$$ln \ \sum_j^n \psi_j \, V_j(t)$$

are the variables representing the government's fiscal Policy?

$$ln \ \sum_k^m \varphi_k \, W_k(t)$$

are the variables representing effectiveness of the government's performance, regulations?

$$ln \ \sum_l^o \omega_l \, Z_l(t)$$

are the variables representing rent seeking?

3. RESULT AND DISCUSSION

Economic growth may be established as a direct result of political administration arrangements, operationally capable of making decisions and regulations determining the development of economic activities. The arrangement of political administration is operationally dependent on incentives. The tug of war among various parties will end when all the parties may negotiate at no cost. Offers will be proposed to internalize externality potentials by increasing the size of the total surplus that can be shared.

Lawrence Friedman, in a discussion on concerning law as an effective system, said that law did not merely work depending on rules and regulations (legal substance) issued by the government. In fact, institutions (legal structure) also played an important role in the effectiveness of the law. Institutions were likened to an engine that produced and ran the substance of law. Without a well-run engine, the products produced would be troublesome. In this context, the study was relevant to that phenomenon. Regulations required a highly achieving institution as an engine producing and running those regulations to positively impact on growth.

Furthermore, Friedman also included a culture element (legal culture) as one of the next determinants for the purpose of legal system that was well-run. Culture in the society included cultures thriving on the law enforcers and lawmakers (legal structure) that would play a crucial role in the effectively run law. If that culture was damaged, the law enforcement and even law substance produced would negatively be affected.

This part was intended to clarify the influence of institutional variables originating from good regional governance more. The term governance was a variable of regional government effectiveness divided into two emphases namely policy effectiveness and organizational effectiveness. Policy effectiveness of a regional government showed how a Regional Parliament institution (politicians) and a regent/mayor together with

his/her officials (bureaucrats) synergized in executing the government's functions namely budgeting, regulation and supervision functions. Meanwhile, organizational effectiveness was duties and authorities of a regent/mayor together with his/her RWU in both compulsory affairs administration and optional affairs administration.

Table 1 Influence of Institutions in the Convergence Model (Dynamic Panel)

Variable	xtdpd Two Step Vce Robust							
L1.l ogyc	-0.1668***	-0.1704***	-0.1759***	-0.2026***	-0.2256***	-0.1758***	-0.2355***	-0.2514***
log(sk)	-0.1033***	-0.1068***	-0.0996***	-0.0944***	-0.0793***	-0.1052***	-0.0765***	-0.0890***
log(n+g+δ)	0.0056*	0.0044(*)	0.0065*	0.0082***	0.0083**	0.005883*	0.0078**	0.0015
log(sh)1	0.6432***	0.6430***	0.6245**	0.5070***	0.4190***	0.6261***	0.3878***	0.2895***
log(sh)2	0.00681***	0.0051***	0.0065***	0.0108***	0.0107***	0.0053***	0.0120***	0.0062***
G^c/y	-0.1706***	-0.1186*	-0.1265*	-0.3451***	-0.4054***	-0.065	-0.4600***	-0.3135***
G^p/y	-0.8219***	-0.8377***	-0.8290***	-0.7445***	-0.7636**	-0.8462***	-0.7444***	-0.7278***
(x+m)/y	0.0090***	0.0087**	0.0090**	0.0153***	0.0143***	0.0097**	0.0158***	0.0211***
inst1		0.0165***				0.0130***		0.0538***
corr1			-0.0030***			-0.0031***		-0.0035***
reg				0.0033***			0.0017***	0.0030***
bperd					-0.0100***		-0.0081***	-0.0082***
_cons	0.8623***	0.8588***	0.9213***	1.1300***	1.4186***	0.90631***	1.4684***	1.5944**
N	2466	2466	2.466	2466	2466	2466	2466	2466
z1 (prob>z)	-1.9418 (0.0522)	-1.9234 (0.0544)	-1.9176 (0.0552)	-1.9292 (0.0537)	-2.2897 (0.0220)	-1.9118 (0.0559)	-2.1183 (0.0342)	-2.0381 (0.0415)
z2 ((prob>z))	-1.4691 (0.1418)	-1.5211 (0.1282)	-1.5685 (0.1168)	-1.7293 (0.0838)	-0.1.5876 (0.1124)	-1.5871 (0.1125)	-1.7089 (0.0875)	-1.8199 (0.0688)
b	0.1668	0.1704	0.1759	0.2026	0.2256	0.1758	0.2355	0.2514
1-b	0.8332	0.8296	0.8241	0.7974	0.7744	0.8242	0.7645	0.7486
-λT	-0.182481577	-0.186811662	-0.1934634	-0.22639884	-0.25566674	-0.19334206	-0.26853325	-0.289550488
λ	0.03041359 5	0.03113527	0.0322439	0.037733141	0.042611124	0.032223677	0.044755542	0.048258414
%λ	3.04%	3.11%	3.22%	3.77%	4.26%	3.22%	4.48%	4.83%
T1/2	22.79	22.26	21.49	18.37	16.26	21.51	15.48	14.36

The analysis that could be made to explain the findings in Table 1 was how a regional legislative branch and executive placed their own roles and contribution in the administration of government functions. The negative estimation results given by the variable of policy effectiveness on growth showed that the output of the synergy between the executive branch (Regent/Mayor and RWU) and the legislative branch (Regional Parliament) in carrying out their functions could reduce growth.

Decentralization was supposed to encourage democratization and rules of games in the management of the state and the administration of government characterized by a power sharing among the state institutions. Not only did the administration of government determine allocations and utilizations of resources, but it also restructured the economy to drive a business climate in the society. With a restructuration, it was expected that we could avoid the government's inefficiency, macroeconomic instability, and growth insufficiency through the establishment of a conducive business climate. A business climate would encourage activities in other sectors such as creating new jobs, increasing production, and expanding exports. Therefore, economic stabilization would be realized, and uncertainty would be reduced.

4. CONCLUSION

This study was aimed at investigating the relations between institutions and the speed of convergence and its influence on income growth. Models that were built employed Solow's Augmented Growth model used by Mankiw, Romer and Weil by adding the concept of institutions from Bassanini and Scarpetta and Romer [9]–[11]. Not only did the model elaborate the influence of institutions on growth, but it also identified whether institutions could accelerate or slow down convergence.

The estimation results showed that both absolute convergence and conditional convergence occurred in regencies/cities in Indonesia in the years of 2009-2015. The speed of convergence at conditional convergence was higher than that of absolute convergence after calculating physical capital, human capital, and

population growth. This study confirmed the findings of Solow's augmented growth model predicting that physical capital and human capital positively and significantly impacted on income growth, while population growth negatively and significantly impacted on income growth.

This study found out that regencies had the higher speed of convergence than that of cities. Similarly, the speed of convergence in Indonesian large islands was higher. Consecutively, islands that had the higher speed of convergence were Sulawesi, Java, Sumatera, Kalimantan, Bali-Nusa Tenggara, and Maluku-Papua. This study also found out that in a period when a general election was held, the speed of convergence was higher than that of post general election. This showed that a general election encourages a government that accelerated development and the economy in order that its credibility increased. Meanwhile, right after a presidential election, the president-elect and the vice president-elect were still busy consolidating and coordinating with the coalition parties to form a coalition government.

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