

ABSTRACT

Indonesia has implemented fiscal decentralization system as a solution for the problems of regional inequality and high dependency level of local government to central government. But, data stated regional inequality tends to increase after the implementation of fiscal decentralization. Therefore, this study aims to analyze the degree of fiscal decentralization and regional inequality in Indonesia. Specifically, this study objects to evaluate the implementation of fiscal decentralization and examine the impact of fiscal decentralization to regional inequality in Indonesia.

This study use fiscal decentralization indices developed by Vo(2008) to measure the degree of fiscal decentralization, Williamson index to measure the degree of regional inequality, and dynamic panel data analysis with Arrelano Bond Generalized Method of Moments (GMM), which is Two-Step System GMM to show the impact of the fiscal decentralization indices to regional inequality. The object of this study is 32 provinces in Indonesia 2004 – 2013.

The results showed that the degree of fiscal decentralization in Indonesia is relatively low. Regional inequality is relatively stable in 2004 – 2013, but the degree of regional inequality is exceptionally high in rich provinces. Dynamic panel data analysis showed that lagged regional inequality variable, degree of fiscal decentralization, and education has positive and significant relationship to regional inequality. Per capita household expenditure variable and role of government has negative and significant relationship to regional inequality, meanwhile health has no significant effect to regional inequality.

Keywords: Fiscal decentralization, regional inequality, Two-Step System GMM