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Local Autonomy in Indonesia, Fall Short: Case Study East Java Province

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Abstract

Not until 2001 the government of Indonesia introduced local autonomy to the level of regional governance. This national policy aims to increase the alignment and relevance of government programmes with regional needs and encourage significant participation of community on regional development. Local autonomy is considered as an enabler for regional government to improve regional welfare, which at the end believes to be factor that improves national welfare. Local autonomy has been interpreted as encouraging local governance to allocate more significant percentage of budget for capital expenditures, which is believed to be the key to boost economic growth and employment. These two factors have been acknowledged as the variables that influence welfare. This explanatory research aims to evaluate the implementation of local autonomy and indicate whether the implementation served its purpose as indicated by previous studies. It applied structural path analysis to evaluate relations between aforementioned variables. The sample for this study was taken from 38 regencies and cities in East Java over the period from 2006 until 2011. The result shows that although local autonomy has significant and positive influence on capital expenditure, but at the end it fails to positively influence economic growth. Furthermore, it also shows that the increase of employment does not positively influence the public welfare.

Key Words: *Capital Expenditure, Economic Growth, Employment, Explanatory Research, Local Autonomy, Welfare.*

Introduction

The implementation of local autonomy at regional government is believed bringing significant impact on distribution of economic growth and welfare among regions. Local autonomy is used as a mean to realize a better, just, and prosperous nation. (Sarundajang, 2002). Given more rights to a regional government and wider participation of regional community in planning, budgeting, and utilizing local resources for local development, it is expected that regional development can be administered effectively and efficiently (Saragih, 2003).

The delegation of mandate through local autonomy by central government to regional governments is followed by fiscal decentralization. Central government conveys more financial resources to regional governments. These resources are supposed to be used for financing regional government's operation as well as regional development programmes, which may include capital expenditure, improving employment rate and welfare. Local autonomy coerces a regional government to be ready to accept more responsibility in governing and managing its house-affairs. The regional government needs to improve its capabilities to optimize existing resources and discover new potential resources in order to increase regional income. Fiscal autonomy as part of local autonomy will expose the capability of regional government in increasing its regional income, such as taxes, retributions, etc. Hence, all financial shares from central government are temporal support for regional government. Their role is as a booster which objective is to ignite the production engines of the regional government. However, a number of studies indicate that the implementation of local autonomy in Indonesia proof differently. World Bank (2003) reports that at the early implementation stage of local autonomy in Indonesia, regional governments were highly depending on financial distribution from central government through general allocation funding instrument. The instrument satisfied almost 90% of regional governments' annual income.

A study by Kuncoro (2007) confirms the previous study and suggests that regional income of a regional government only covers up to 20% of the regional government's expenditure. Table 1 shows regional original income, total regional government annual budget, and percentage of regional original income over total budget of regional governments in East Java Province, Indonesia in 2009 and 2011. Almost all regional governments (aside from Sidoarjo, Tuban, Gresik, and Surabaya) have higher percentage (above 50%), which indicates that in general regional governments have higher dependency on financial shares from central government to cover their expenditures. These may indicate that the implementation of regional autonomy has missed its target, i.e. bringing significant impact on distribution of economic growth and welfare among regions.

This study aims to provide a proof through empirical data analysis that the implementation of local autonomy has fail. It also provides factors that may have cause the failure. The analysis used regional governments in East Java Province as its data. East Java province is chosen because of two man reasons. First, it is the largest province in Indonesia in term of number of regions/cities. Second, it is the second largest province (after DKI Jakarta) in term of annual regional budget.

Influencing Variables

According to previous empirical studies (Saragih, 2003; Parguez and Bliek, 2007), in order to stimulate economic growth government needs to increase its capital expenditure in its routine expenses. Physical public service developments, such as clean water, education, roads, railways, telecommunication, etc., may create and promote a conducive environment for infrastructure investment on physical services, which at the end improve efficiency in various sectors. It has a multiplier effect, i.e. facilitates economic activities and provides more jobs in the market. Todaro and Smith (2003) identifies the availability of sufficient infrastructures for public services, such as clean water, food, education, health, and transportation, is one of government expenditure that can positively significant influence on welfare. The capital expenditure can impose effectiveness and efficiency in various sectors, which at the end stimulates economy development of the community.

Furthermore, region's local autonomy is measured by the capability of regions/cities to explore their local financial resources. The degree of local autonomy of a region/city influences the capability of the region/city to provide financial resources for its operations. The higher the degree of region's local autonomy, the bigger the capability of region/city to allocate more budgets for capital expenditure. Thus, region's capital expenditure is expected to increase economic growth and employment in the region. If economy is growing and employment rate is high, then the idea of development as stated in the Indonesia's constitution has been achieved.

Conceptual Model

The conceptual model is built on a number of hexogen, intervening, and endogen variables. Figure 1 shows the proposed conceptual model. First, the region's local autonomy influence capital expenditure. As one of regional autonomy indicators, financial independence degree indicates the level of region's authority and capability to explore, manage, and utilize its financial resources. The higher the autonomy level, the higher the capability of regional government in exploring regional financial resources. With bigger financial resources, regional government will have higher capability in allocating funding for expenditure. A number of studies (Oates, 1972; Musgrave, 1973; Romer, 1990; Bahl, 1999; Todaro and Smith, 2003) suggest that fiscal decentralization encourages regional government in spending financial resources for more local expenditure that meets local needs.

Second, expenditure influence economic growth. Expenditure for acquiring or developing tangible fix assets, which have beneficial values after 12 months, such as lands, machines, properties, irrigations, and transportation networks, contributes be used in implementing regional government's development programmes (Todaro and Smith, 2003; Calderon and Serven, 2004; Le and Suruga, 2005; Schaltegger and Torgler, 2006; Gregorio and Ghosh, 2009; Marrocu and Paci, 2010). Access to good infrastructure stimulates economic activities by community and investment. These contribute to economic growth. The more the regional government's investment in infrastructure development, the higher the acceleration of local economic growth.

Third, capital expenditure positively influences employment. Capital expenditure, such as building networks, buildings, markets, bridges, irrigations, and communications, creates jobs for regional community (Todaro and Smith, 2003; Ball and Wood, 1995; Parguez and Bliek, 2007). It also generates other economic activities, such as food, health, education, and housing, which at the end creates more jobs.
Fourth, economic growth positively influences employment. Better access to good education, health services, and public services stimulates the improvement of labor productivity (Todaro and Smith, 2003; Padalino and Vivarelli, 1997; Boltho and Glyn, 1995). The influence of economic growth over employment can be explained through employment elasticity. High elasticity indicates that the pacing of economic growth creates bigger employment opportunities.

Fifth, economic growth positively influences welfare. Economic growth implies the fulfilment of basic needs, such as food, clothes, houses, education, and health, which increase welfare (Todaro and Smith, 2003; King, 1998; Moon. and Dixon, 1992; Massuanganhe, 2005).

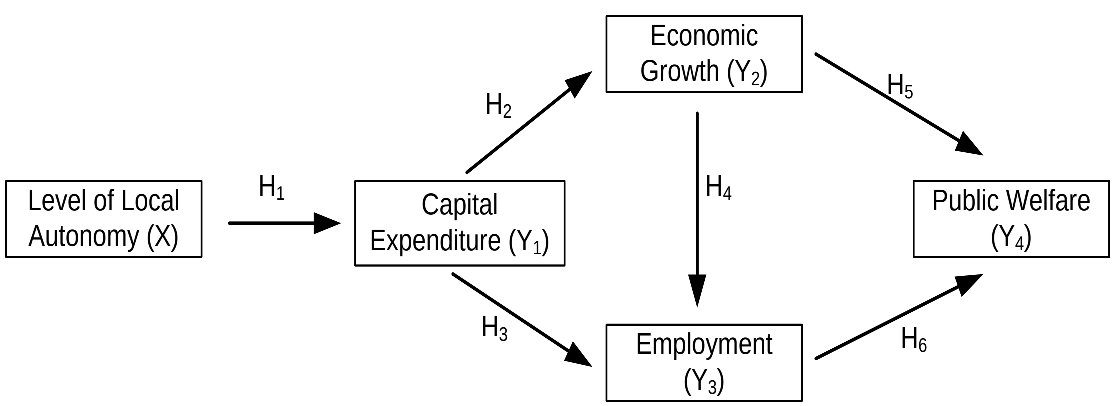

Figure 1 The conceptual model.

Lastly, employment positively influences welfare. The more percentage of population actively involved in economic activities, the more funding through earnings allocated by families for education, health, and other cost components (Todaro and Smith, 2003; Padalino and Vivarelli, 1997; Boltho and Glyn, 1995).

Based on prepositions from previous theoretical and empirical studies, this study proposed the following a number of hypothesis.

H1. Local autonomy of regions/cities in East Java significantly influences regional capital expenditure;
H2. Capital expenditure of regions/cities in East Java significantly influences regional economic growth;
H3. Capital expenditure of regions/cities in East Java significantly influences regional employment;
H4. Economic growth of regions/cities in East Java significantly influences regional employment;
H5. Economic growth of regions/cities in East Java significantly influences regional welfare;
H6. Employment of regions/cities in East Java significantly influences regional welfare.

Research Methodology

This explanatory research tried to analyze and provide explanation on influences between variables in order to answer research hypothesis. Path analysis is used to serve the purpose of the research (Solimun,2002). The following steps were performed: (1) developing hypothesis model based on concepts and theory, (2) verifying path analysis assumptions, (3) parameter estimation or path analysis calculation, (4) validating model, and (5) interpreting result.

Sample Population

The objects of this research were 29 regencies and 9 cities in East Java Province for the period of 2006 and 2011. This research used secondary data collected using census method by pooling 228 observations out the 38 regencies and cities in East Java Province. The data sources were taken from Publication Report of Central Bureau of Statistic of East Java Province (such as East Java in Numbers, Social and Economy Macro Data of East Java, Human Development Index, and Indonesia Statistics), magazines, and internet.
The collected data was analyzed in the following manner: (1) verifies data, (2) composes data tabulation, (3) processes data, and (4) analyzes data for the purpose of testing the hypothesis.

Hypothesis Model

As already mentioned, Figure 1 shows the concept and hypothesis being explored in this research as a path analysis model. The path analysis model can be rewriten in a set of equations. The equations is called a simultaneous equation system or structural model. The equations are as follows

$$Y1_{it} = p_1 X_{it} + \varepsilon_{it} \quad (1)$$

$$Y2_{it} = p_2 Y1_{it} + \varepsilon_{it} \quad (2)$$

$$Y3_{it} = p_3 Y1_{it} + p_4 Y2_{it} + \varepsilon_{it} \quad (3)$$

$$Y4_{it} = p_5 Y2_{it} + p_6 Y3_{it} + \varepsilon_{it} \quad (4)$$

where X is the degree of local autonomy of a regency/city at a time/period, *Y1* is capital expenditure of a regency/city at a time/period, *Y2* is the economic growth of a regency/city at a time/period, *Y3* is the employment of a regency/city at a time/period, *Y4* is the public welfare of a regency/city at a time/period, *p1* ... *p6* are the path coefficients, *i* is series of regencies and cities, t is series of time/period, and ε is residual coefficient of a regency/city at a time/period.

Halim (2007) suggests that local autonomy can be measured through the degree of fiscal decentralization between central and local governments. The degree of fiscal decentralization can be formulated as follow:

$$Degree\ of\ Fiscal\ Decentralization = \frac{Original\ Local\ Revenue}{Total\ Local\ Revenue} \times 100\% \qquad (5)$$

The local autonomy variable in this study could indicate how significant local government role in exploring its original revenue sources. Table 1 shows the local autonomy of regencies and cities in East Java Province from 2005 until 2011. The table indicates that most of the regions (84%) have below 10% of local autonomy. Only six of them have higher than 10% of local autonomy value. Sidoarjo and Gresik regencies have higher rate of local autonomy due to the fact that both regencies are known as industrial and trading centre. The average values of fiscal decentralization in East Java Province in the period of 2005-2010 are 8.31%, 7.33%, 7.05%, 7.06%, 7.55% and 7.76% respectively. These indicate that the level of local autonomy in regencies and cities in East Java Province in general was more or less stagnant.

Capital expenditure represents the amount of expenses with regards to acquirement, acquisition, or development of fixed tangible assets for government activities. A fixed tangible asset is a tangible asset that has 12 months utility value, such as lands, equipments, machineries, buildings, constructions, roads, irrigations, and communication networks. According to Ministry Decree Number 37/2010 about Guidance on Planning the Local Government Budget and Expenditure - 2011 Fiscal Year, capital expenditure is planned based on estimated local government expenses, which are fairly and equitable allocated for the sake of the people. These expenses are targeted to improve the quality and quantity of public services and infrastructures that promote investment in the regions.

Economic growth is represented by amount of regional gross domestic product of regions and cities. In this study, the data is based on current current price. This is because that data in fiscal decentralization, which includes local original income, tax revenue sharing with central government, and non-tax revenue PAD, is in current price. In general, the regional gross domestic product of regions and cities are varies, between 11.93% up to 28.6%. Interesting fact can be quickly drawn that the increase of economic growth is not parallel to the increase of capital expenditure. Employment is measured by the number of working age people who has jobs. Table 1 shows the employment growth. It indicates that the employment growth is low for regencies and cities in East Java Province.

Table 1. East Java Province in Numbers (2005-2010)

	2005	2006	2007	2008	2009	2010	2011
Fiscal Decentralization	8.31	7.33	7.05	7.06	7.55	7.76	n.a
Capital Expenditure	-4.71	258.96	12.96	46.89	11.86	-24.98	n.a
Economic Growth	n.a	15.54	22.68	15.55	11.90	13.30	13.15
Employment	n.a	1.05	6.44	0.97	3.05	-3.87	1.85
HDI	n.a	68.42	68.42	69.09	69.58	70.14	70.71

Public welfare represents a condition where the quality of living standard which is indicated by the economy and social condition of society. UNDP introduces an index to measure the improvement of economy and social condition of society which includes life expectancy, educational attainment and income. This index is called Human Development Index (HDI). In this study, public welfare is measured by the HDI indicators. Table 1 indicates that in general HDI indicators in regions and cities in East Java Province are improved.

Path Analysis Assumptions Verification

The next step in path analysis is verifying basis assumptions used in the model. The following assumptions are used in this research:

1. Relation between variables in the model was linear, meaning that any change in the variable was a linear function over other causal variable;

2. Only recursive model could be considered, that is a causal flow system which directs to one course. It also means that any model that contains reciprocal causal could not be analyzed using path analysis;

3. Variables being measured were interval and ratio scale;

4. Variables being observed were only valid measured variables (measuring instruments were valid and reliable);

5. Analyzed model was specified (identified) based on sound and relevant theories and concepts.

Result and Discussion

Path Coefficient Calculation or Parameter Estimation

For parameter estimation and path coefficient calculation, the research utilized statistical tools in regression analysis (standardized). The scale of effect of hexogen variable is measured by the numeric value of path coefficient. Table 2 describes the statistical data used in the study.

Tabel 2. Sample Correlation, Mean, and Standard Deviation for the Model

	N	Minimum	Maximum	Mean	Std.Deviation
Local Autonomy	228	2.71414	26.0149	7.5101249	3.84957504
Capital Expenditure	228	9880378000	1.E12	1.36E11	1.064E11
Economic Growth	228	1.036	99.526	15.35384	8.235150
Employment	228	51219	1399193	492310.80	294441.814
Welfare	228	56.27	77.89	69.8741	4.85387

Model Validation

Model validation was conducted checking whether aforementioned assumptions for path analysis were satisfied. In model validation, path coefficient and regression testing were conducted to measure significant level of t test. Table 3 shows the result of model validation, where β stands for path coefficient value and p-value is the probability value. The result of verification can be interpreted as follows:

Tabel 3. Path Coefficient and t-value on Hypotesis

Exsogen	Endogen	B	t-test	p-value
Local Autonomy	Capital Expenditure	0,391	6,389	0,000
Capital Expenditure	Economic Growth	- 0,059	- 0,881	0,379
Capital Expenditure	Employment	0,578	10,633	0,000
Economic Growth	Employment	-0,038	-0,693	0,489
Economic Growth	Welfare	0,010	0,149	0,882
Employment	Welfare	- 0,197	- 3,011	0,003

1. The level of local autonomy positively (path coefficient and t-value are positive) and significantly (p-value smaller than the significant level, i.e. 5%) influences capital expenditure. Figure 2 illustrates the relation between local autonomy and capital expenditure in the period of 2005-2010. This result supports the first hypothesis, i.e. the level of local autonomy significantly influence the amount of capital expenditure spent by regencies and cities in East Java Province.

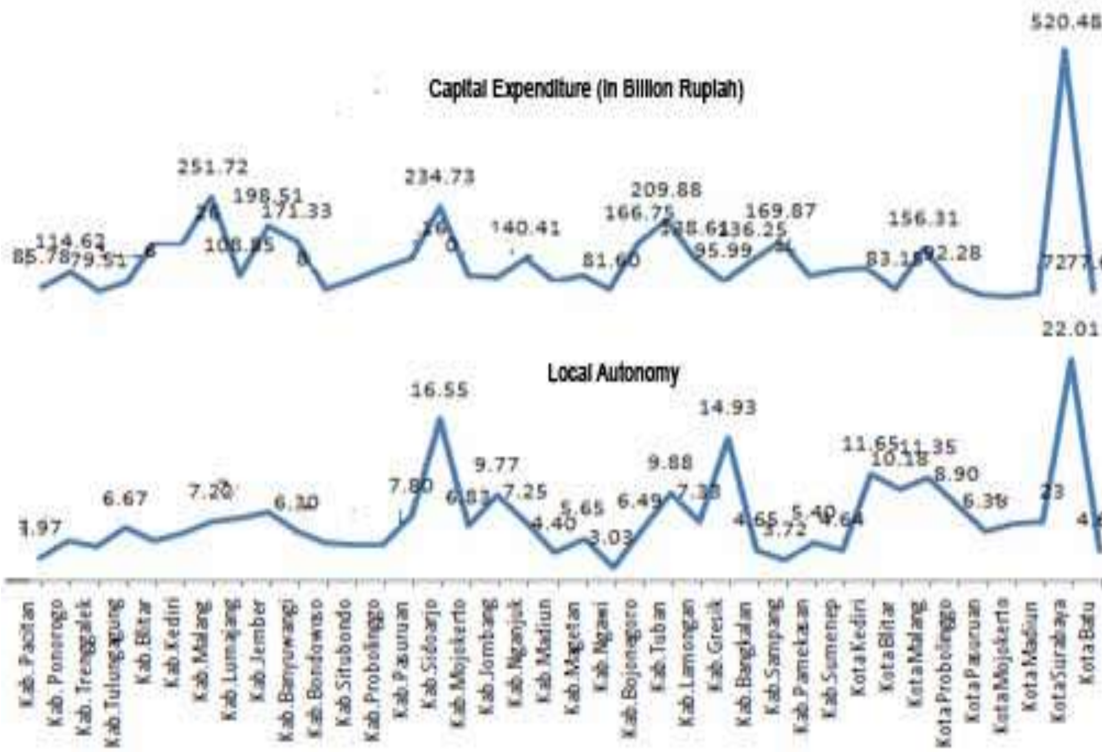

Figure 2. Local autonomy and capital expenditure: 2005-2010

2. Capital expenditure has insignificant effect on economic growth. This is indicated by the p-value which is higher than the significant level. Figure 3 illustrates the relation between capital expenditure and economic growth in the period of 2005-2010. This result does not support the second hypothesis, which proposes that the amount of capital expenditure significantly influences economic growth in regencies and cities in East Java Province.

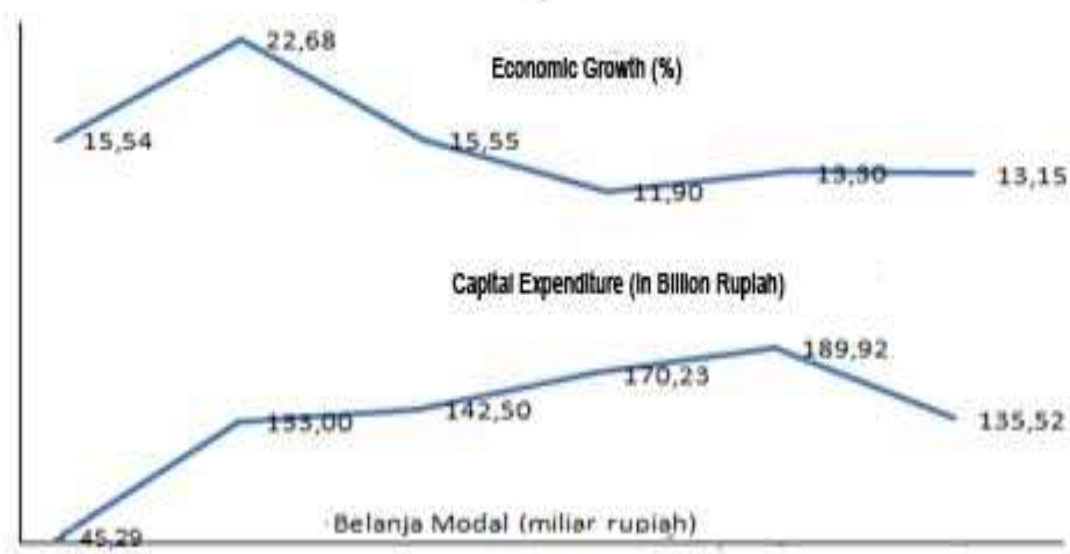

Figure 3. Capital expenditure and economic growth: 2005-2010

3. Capital expenditure positively (path coefficient and t-value are positive) and significantly (p-value smaller than the significant level) influences employment. Figure 4 illustrates the relation between capital expenditure and employment in the period of 2005-2010. This result supports the third hypothesis, i.e. the amoun of capital expenditure significantly influence the rate of employment.

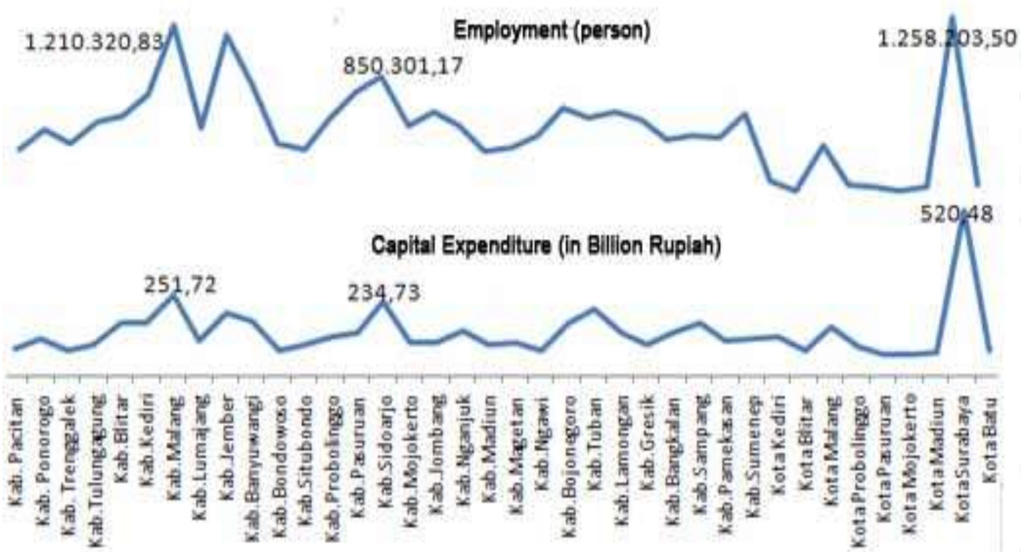

Figure 4. Capital expenditure and employment: 2005-2010

4. Economic growth has insignificant effect on employment. This is indicated by the p-value which is higher than the significant level. Figure 5 illustrates the relation between economic growth and employment in the period of 2006-2011. This result does not support the fourth hypothesis, which proposes that the economic growth significantly influences the rate of employment in regencies and cities in East Java Province.

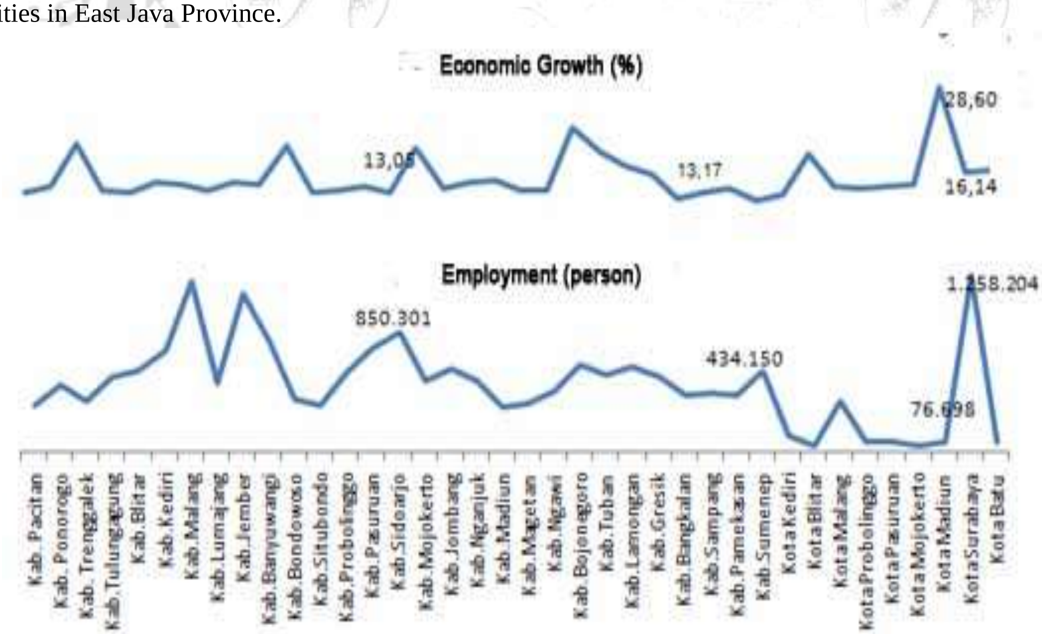

Figure 5. Economic growth and employment: 2006-2011

5. Economic growth has insignificant effect on welfare. This is indicated by the p-value which is higher than the significant level. Figure 6 illustrates the relation between economic growth and welfare in the period of 2006-2011. This result does not support the fifth hypothesis, which proposes that the economic growth significantly influences welfare in regencies and cities in East Java Province.

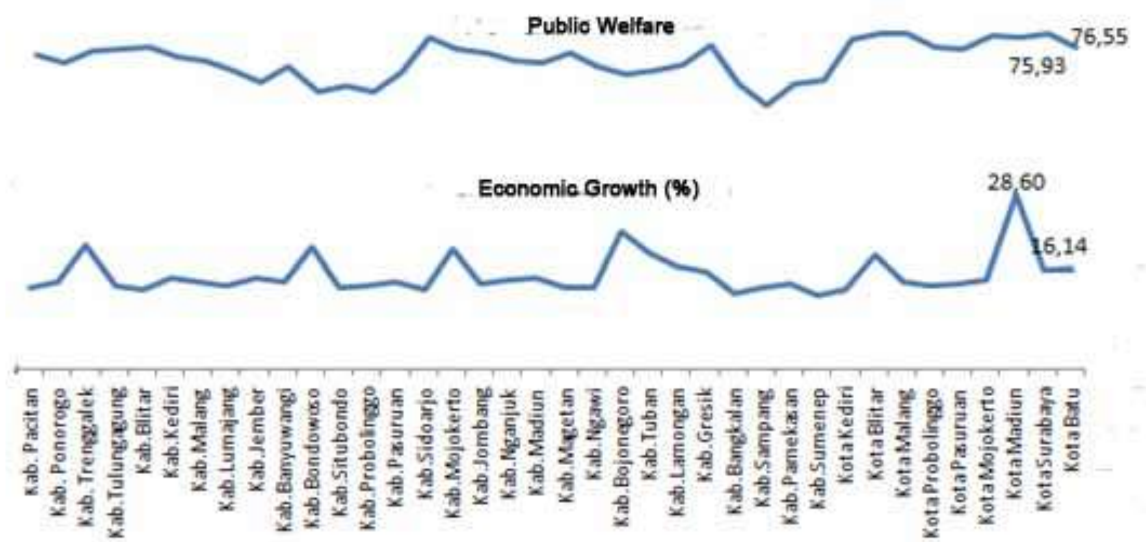

Figure 6. Economic growth and welfare: 2006-2011

6. Employment significantly (p-value smaller than the significant level) but negatively (path coefficient and t-value are positive) influences welfare. Figure 7 illustrates the relation between employment and welfare in the period of 2006-2011. This result supports the sixth hypothesis, i.e. the rate of employment significantly influences welfare in regencies and cities in East Java Province.

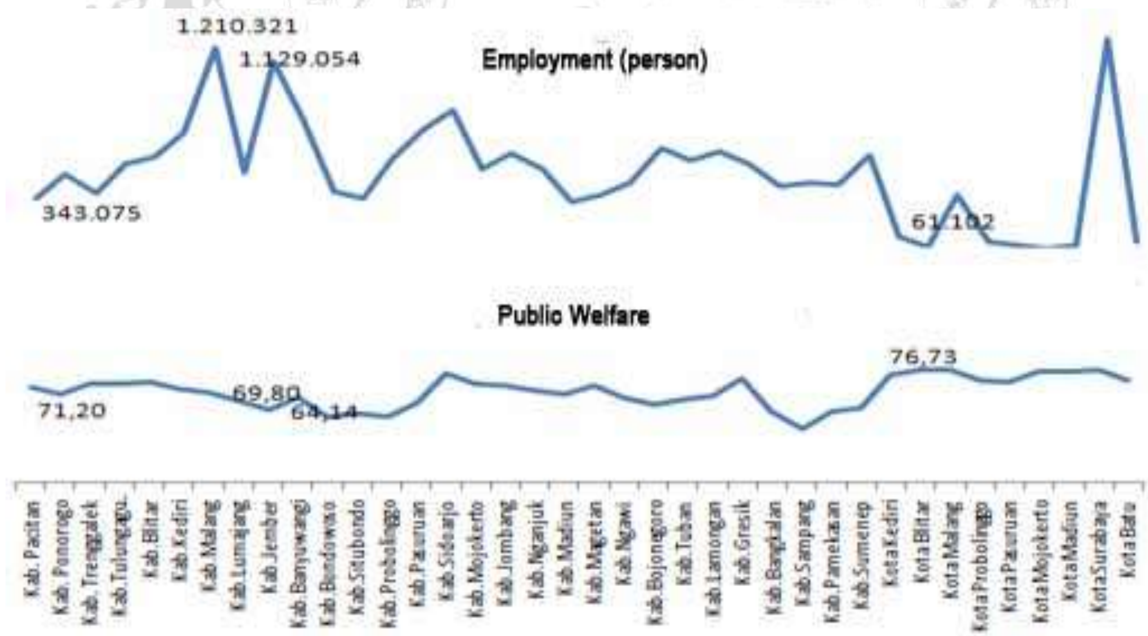

Figure 7. Employment and welfare: 2006-2011

Interpreting Analysis Result

The last process in path analysis is interpreting of analysis result. Interpretation in path analysis covers:

1. Provide sound explanation on phenomena or problems under studied.
2. Decide independent variables which significantly influence dependent variables and trace independent variable paths mechanism over dependent variables or through intermediate variables.
3. Test the model, that is, compare the theoretical concepts against empirical facts in order to conclude whether the result support the existing concepts or even developing new concepts.

First, the analysis of model verification depicts that the level of local autonomy has a positive and significant effect on the amount of resources that regencies or cities would spend as capital expenditure. This result is inline with the fact that local autonomy indicates the capability of local government in funding their own expenses without the support from central government. An autonomous local government would extensively explore their local potential resources, manage and utilize its financial resources for financing its activities and programmes. Spending more resources for capital expenditure is expected to increase the number of economic activities (trades, industries, and services) in the region. The increase of economic activities would increase local government revenues from taxes and other levies. This in return would increase the percentage of original local revenue, which at the end increase the level of local autonomy of the regency or city.

This first finding is supported by previous study from Halim (2007) which states that the autonomy of a region can be measured by the region's financial capability to finance its activities and programmes. In this study, the level of local autonomy, which is measured by region's capability in increasing region's income, such as regional original income, has significant positive influence on region's capital expenditure during the period of 2005 until 2010. Another empirical study by Lin and Liu (2000) is also inline with the first finding. This study finds that fiscal decentralization promotes economical efficiency, which includes capital accumulation. It becomes the major contributor for economic growth in Tiongkok during 1980 until 2000.

Second, the analysis of model verification depicts that capital expenditure has insignificant effect on economic growth. This finding contradicts with a number of studies (Todaro and Smith, 2003; Mursinto, 2004; Calderon and Serven, 2004, Zhang and Zao, 1998, Davoodi and Zou, 1998). According to Todaro and Smith (2003), increment in capital goods, which are targeted to gain output or benefit in the future, such as new factories and production machineries and equipments, would result in significant increment of productivity. Furthermore, development of infrastructures, such as roads, electricity, water, and sanitation, and communication network, would provide facilities and integration of economic activities, which will improve productivity and promote economic efficiency. This would positively and significantly influence economic growth. According to Mursinto (2004), there is a positive and significant correlation between development expenses and gross regional product (GRP) of regencies and cities in East Java Province. Another study by Calderon and Serven (2004) concludes that the increment of infrastructures owned by a country has positive and significant correlation to economic growth.

According to Halim (2004), although capital expenditure, in the form of physical infrastructure investments, has economic value and can become local assets which would offer direct benefit to community, the investments may not immediately deliver profit or meet the prerequisite benefits from financial analysis perspective, in the long term such capital expenditure would expedite economic activities of the community accelerate mobility of goods and services, speed transactions, and at the end pacing economic growth in the region.

The different result can be explained as follow. The tendency of decrement of capital expenditure contribution to region's total expenses indicates that indirect spending (especially personnel expenditure) is still dominating the region's total expenses of regions and cities in East Java Province (48.13% in average during the period of 2005 until 2010). It is relatively higher compare to the proportion of capital expenditure to total expenses, that is 17.13%. According to Kaho (2003), the region's budget expansion policy, which allocates relatively bigger budget for operational expenses (personnel expenditure) than capital expenditure could not boost economic growth in the region. This factor probably the reasonable cause for the fact that the level of local autonomy fails to significantly and positively influence economic growth of regencies and cities in East Java Province.

Another interesting fact that was immerging is the path coefficient of relation between local autonomy and capital expenditure of regencies and cities in East Java Province has negative value. This probably caused by two factors. First, capital expenditure in regions and cities in East Java Province is still focusing on unproductive sectors, such as sanitary and public health. These sectors do not have immediate and direct effect to economic activities in the regions. Second, although a small part of capital expenditure is indeed allocated on productive sectors, most of the sectors are the kind of long-term investment, such as irrigations and bridges. This kind of investment would take years before they contribute to the economic growth.

This second finding is inline with the result from the study by Subiyanto (Halim, 2008) and Kaldor (Pressman, 2000). This study suggests that investments on public service sectors such as health, sanitation, and education, would not produce income. These investments may only become permanent cost centers to local governments, especially when they are not regularly maintained, because they become impediments.
Third, the analysis of model verification depicts that capital expenditure significantly and positively influences employment. This third finding is inline with a number of studies (Samuelson, 2003; Halim, 2008; Sasana, 2008; Wurarah, 2011). There was high unemployment rate in regions and cities in East Java Province. The macro economy condition prevented private sectors to absorb these unemployed labours. According to Keynes (Pressman, 2000) and Delioarnov (2005), the local governments would try to resolve the problem through fiscal policy. They created more infrastructures projects, which were expected to instantly create more new jobs. The study by Sasana (2008) on regencies and cities in Central Java Province from 2001 until 2005 and Wurarah (2011) in regencies and cities in West Papua Province also support this finding. However, one point that needs to be emphasized here is that employment is not only determined by capital expenditure.

Fourth, the analysis of model verification depicts that economic growth has insignificant effect on employment. This finding contradicts with a number of studies (Ermawati, 2008; Sasana, 2008). The study by Ermawati (2008) on regencies and cities in West Nusa Tenggara Province from 1996 until 2005 indicates that economic growth has significant but negative influence on employment. Sasana (2008) indicates that economic growth has significant and positive influence on employment.

This finding is not inline with Output Employment Macro Model Theory, which was developed by neo classic economists. This theory tries to explain the relation between capital accumulation, the growth of industries' ouput, and job creations (Todaro and Smith, 2003). The accumulation of capital should drive the growth of industries' output. The growth of industries' output indicates economic growth, which would result in the creation of massive new jobs. New jobs would mean new potential income for community, especially for the poor. The increase of family income would trigger the increase of regional consumption, which then supposes to trigger more industries' ouput. Furthermore, according to Okun's Law, a high output growth has negative relations with the level of budgeting and unemployment (Blanchard, 2003).

This fourth finding can be explained as follow. The insignificancy could be caused by the fact that during the period, only second-tier and third-tier sectors were growing. Production acitivities were capital intensive on subsectors like trades, hotels, restaurants, or processing industry (it contributed almost 60% of production activities in East Java Province). Those production activities only involve specific and skilful workers. Whereas according to Bappeprov (2011), the major part of unemployed labours in East Java Province has low education level (primary school and junior high). Therefore, the economic growth in regencies and cities failed to observe the unemployed workers in order to significantly increase employment in East Java Province. This study is inline with the study by Feriyanto (2012), which was conducted on Indonesia during the period of 1990-2009.

Fifth, the analysis of model verification depicts that economic growth of regencies and cities in East Java Province has insignificant effect on public welfare. This finding contradicts with a number of studies (Massuanganhe, 2005; Badrudin, 2012). According to Massuanganhe (2005), there is a positive and significant influence of economic growth on the decline of number of poor families. When economy of a region is growing, then the public welfare is improving.

This study is inline with a number of empirical studies (Syamsuddin dan Sholeh, 2005; Moon and Dixon , 1992; King, 1998). According to Syamsuddin dan Sholeh (2005), the pacing growth of industrial sectors and only centralized in certain area within Gerbangkertosusilo (Gresik, Bangkalan, Mojokerto, Surabaya, Sidoarjo, and Lamongan) has created disparity in economic development and growth between regencies, cities, and districs in East Java Province. Furthermore, Jhingan (2008) found that one of the causes of disparity of economic growth is when economic growth is only enjoyed by a number of rich families. The widening gap would trigger a race of criminality index and demote public satisfaction.

Furthermore, the studies by Sukimo (2010) and Todaro and Smith (2003) introduce a new concept of economic development. The traditional regime considers economic development as a static parameter, where it is measured only by the increase/decrease of gross or net national product. The contemporary regime also considers all aspects of economic activities, such as education, technology adoption, healthcare, and infrastructure development. Public welfare is achieved only if a government is able to improve not only the family income, but also other components of human development index.

Finally, the analysis of model verification depicts that employment of regencies and cities in East Java Province significantly but negatively influences public welfare. This finding contradicts with a number of studies (Massuanganhe, 2005; Badrudin, 2012; Fatihudin, 2012; Ishak, 2010). Acording to Fatihudin (2012) and Ishak (2010) the employment rate of regencies and cities iin Easter Borne has a significant and positive influence on public welfare.

Human Development Index (HDI) measures performance of countries with regards living standard in three primary dimensions, purchasing power parity (PPP), life expectancy, and education attainment. According to BPS (2012a), the employment of regencies and cities in East Java Province during 2005-2010 was dominated by informal sectors (67.7%), such as part-time labor, working in family businesses (unpayed labor), and self-employed labor. Furthermore, the dependency ratio in East Java Province is quite high. A person who works in informal sectors would not be able to support other people (family members).

The overburden weight (due to dependency ratio) of employed workers tend to diminish their welfare. With regards to minimum wage of regencies and cities in East Java Province, there are several regencies and cities which set their minimum wage lower than the one set by the provincial government. As the result, they failed to increase their buying power in order to satisfy the minimum consumption level, not to mention education and healthcare. The criminality index in the region was also high. This was the effect of the low income. East Java Province was ranked top 4 provinces with the highest with regards with criminality rate. Therefore, it can be assumed that the increase of employment in East Java Province is apparent. These facts probably caused the negative influence of employment on welfare.

This finding is inline with the theory of Adam Smith which states that a development process is started when economy is able to do division of labor (Jhingan, 2008). Division of labor improves productivity, which at the end improves family income. Furthermore, economy scale is an important issue given that through economy expansion, new innovations tend to immerge. This new innovation promotes the expansion of division of labor and economic development.

Conclusion

Base on the analysis and discussion about the effect of local autonomy on capital expenditure, economic growth, employment, and public welfare of regencies and cities in East Java Province, Indonesia, the following remarks can be drawn.

1. Although the level of local autonomy indeed increase the capability of local government to allocate more budget for capital expenditure, but regency or city in East Java Province fails to improve its economic growth. This probably caused by the fact that the major allocation of capital expenditure by local government is for non productive sectors. These non-productive sectors may end up as permanent cost centers. This fact provides sound explanation on why the path-coefficient is negative.
2. Although the increase of capital expenditure of regencies and cities in East Java Province was followed by the increase of employment, but the increase of economic growth of regencies and cities in East Java Province was not followed by the increase of employment. During the period of 2005-2010, the local governments of regencies and cities in East Java Province introduced infrastructure projects in order to boost the instantly creation new jobs. This is because private sectors, due to mouldy condition of macro economic in the region, unable to provide significant amount of new jobs. In the same period, there was a transformation in the region's economic structure, where the role of prime sectors as contributors to economic growth was slowly shifted and replaced by second-tier and third-tier sectors. These sectors require high and specific skilled workers. Therefore, the growth of these two sectors could not influence the growth of employment of regencies and cities in East Java Province.
3. Although a number of theories and previous studies indicate that economic growth should have a positive and significant influence on public welfare, this study founds that the influence is not significant in East Java Province. This probably caused by the fact that the local governments have failed to ensure that the impact of economic growth is distributed evenly. Only limited number of (the have) families who enjoyed the impact of economic growth during the period of 2005-2010. Furthermore, during that period the increase of employment is dominated by informal sectors, where income is mostly under the standard minimum wages. Thus, the dependency ratio is relatively high. The family income is not sufficient to cover expenses necessary for providing needs as suggested in human development index. These would widen the gap between the poor and the have, which foster the increase of criminality and social disturbance. As a whole, the goal of economic growth, i.e. improving public welfare, was not accomplished.

Given these three remarks, it is suggested that the regencies and cities in East Java Province have not been succeeded in implementing local autonomy in their regions. The goal of local autonomy has not been achieved due to aforementioned reasons. The local governments should be more decisive in planning their local development programmes and ensure that it is capital and labour intensive. The capital expenditure should be allocated in sectors which drives real economic development and employment. The local governments have to create programmes that promote the potential sectors which can increase production activities, such as, conducive investment environment, a reliable officers who understand the important of investment and local economy development, accurate information delivery, a stable politics and security condition, law enforcement assurance in regencies and cities of East Java Province. Furthermore, local governments should endorse human capital development programmes. More attention should be allocated to programmes that increase the quality of education and healthcare.

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