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Does Government Fragmentation and Fiscal Decentralization Constrain Leviathan? New evidence from experience in Indonesia

By:
Aan Zulyanto[1*], Lilis Siti Badriah[2]
[1]Faculty of Economics and Business, Muhammadiyah Bengkulu University
[2]Faculty of Economics and Business, Universitas Jenderal Soedirman
[*]Corresponding Author: aanzulyanto@gmail.com

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ABSTRACT: Since the reform era 1999, Indonesia has made a regional proliferation policy and widespread fiscal decentralization policy. Based on the Leviathan hypothesis, the two policies should create a competitive climate and increase the efficiency of government spending. This study aims to analyze the Leviathan hypothesis in Indonesia's regional proliferation policy and fiscal decentralization. The study uses panel data regression from 32 provinces during the 2002-2020 period. The study finds that the Leviathan hypothesis does not apply to Indonesia's regional proliferation and fiscal decentralization policies. Fiscal decentralization and government fragmentation apparently cannot constrain local government size. They have a significant positive effect on increasing it. The results of this study imply that to obtain tangible benefits from regional expansion, a thorough understanding of regional economic potential is needed, as well as the need to improve the quality of human resources to utilize regional potentials optimally.

Keywords: Government Fragmentation, Fiscal Decentralization, Leviathan Hypothesis.

ABSTRAK*: Sejak era reformasi tahun 1999, Indonesia telah membuat kebijakan pemekaran daerah dan desentralisasi fiscal secara luas. Berdasarkan hipotesis Leviathan, kedua kebijakan tersebut seharusnya dapat menciptakan iklim kompetitif dan meningkatkan efisiensi pengeluaran pemerintah. Study ini bertujuan untuk menganalisis berlakunya hipotesis Leviathan dalam kebijakan pemekaran wilayah dan desentralisasi fiscal di Indonesia. Studi menggunakan regresi data panel dari 32 provinsi selama periode 2002-2020. Hasil studi menunjukkan hipotesis Leviathan tidak berlaku dalam kebijakan pemekaran wilayah dan desentralisasi fiskal di Indonesia. Desentralisasi fiskal ternyata tidak dapat menekan perkembangan ukuran pemerintahan, bahkan berpengaruh positif signifikan meningkatkan ukuran pemerintah daerah. Hal tersebut terjadi karena pemekaran daerah di Indonesia lebih disebabkan kepentingan politik. Sebagian besar penerimaan daerah masih bergantung pada transfer pemerintah pusat. Hasil penelitian ini mengimplikasikan bahwa untuk memperoleh manfaat nyata dari pemekaran wilayah, perlu pemahaman yang menyeluruh mengenai potensi ekonomi daerah dan perlu meningkatkan kualitas sumberdaya manusia yang dapat memanfaatkan potensi daerah secara optimal.*

Kata Kunci: *Fragmentasi Pemerintahan, Desentralisasi Fiscal, Hipotesis Leviathan.*

INTRODUCTION

Since the reform era in 1999, Indonesia has strengthened regional autonomy and fiscal decentralization policies. One of the crucial implications of this policy is the formation of new autonomous regions or regional divisions, especially districts and cities. During the 1999-2014 period, there were 223 new autonomous regions, consisting of 8 Provinces, 182 Regencies, and 33 Cities, bringing the whole autonomous regions up to 2014, reaching 542 regions, or an increase of 70 percent compared to 1999. The division and formation of new regions in Indonesia are the fastest and the biggest in the world. No country has experienced changes as fast and as big as the Indonesian government (Zulyanto et al., 2019; Firman, 2009; Niazi, 2012). Due to this situation, since 2014, the government has imposed a moratorium on forming new autonomous regions, except for the Papua region.

Even so, the phenomenon of forming new regions is continuing, bearing in mind that until now, there are still many proposals for forming new autonomous regions. Based on data from the Directorate General of Regional Autonomy of the Ministry of Home Affairs, until September 2022, there were 329 proposals for new autonomous regions consisting of 55 provinces, 247 districts, and 37 cities (Harbowo, 2022). Another signal that shows that regional expansion will continue, among others, can be seen from the results of a regional structuring design study in West Kalimantan Province for 2012-2025 by Partnerships in collaboration with Tanjungpura University, where the study results concluded that until 2025 in West Kalimantan Province there will be added the number of autonomous regions is 12 districts/cities and two provinces (Partnership, 2012).

The emergence of many new autonomous regions has made the Fragmentation of regions in Indonesia even higher. From 2001-2020, Fragmentation in all regions has increased, except for a few areas such as West Java, Bali, Riau, and Jambi. Regions with high levels of Fragmentation include Papua, West Papua, North Maluku, and Maluku. The addition of new areas in the province is also very fast, so the level of Fragmentation is getting higher. This condition is shown in Figure 1.

Fragmentation is beneficial because it can create a climate of competition, encourage efficiency, and prevent fiscal exploitation by local governments. The Tiebout Model (Tiebout M Charles, 1956) and the Leviathan Hypothesis (Brennan & Buchanan, 1980) provide basic arguments about the benefits of Fragmentation in creating government efficiency and economic performance. The combination of competition between government units and the potential for fiscal mobility is the primary driver of efficient and responsive government. The potential for a fiscal exit mechanism or "voting with their feet" and a voice mechanism creates a climate of competition between local governments. The assumption of population mobility between regions, where residents are free to choose where to live according to their respective preferences based on considerations of the facilities available and the level of tax paid, will prevent the government from exploiting taxes that can be detrimental to households and the business world. Empirically, Spencer Banzhaf & Walsh (2008) found strong evidence of this fiscal exit mechanism in environmental quality and community demographic change cases.

In the voice mechanism, the public can put pressure on the government such as in holding elections, direct interactions with legislators, as well as demanding public access to participate in regional policies (Tiebout M Charles, 1956; Hendrick et al., 2011; Sow & Razafimahefa, 2015). Communities can also compare the performance of the government in their area with the performance of governments in other regions, thus influencing the decisions to be taken to elect officials or their representatives in government. Thus the community can better control the policies made by the local government (Persson & Tabellini, 2004). Oates (1999) believes that competition in fragmented structures guarantees efficient public services and reflects people's preferences, and for these unique preferences, people may give up the benefits of centralized production efficiency. Competition creates incentives to provide optimal service at low cost, thus encouraging efficiency, and responsiveness, and increasing community satisfaction (Callanan et al., 2014).

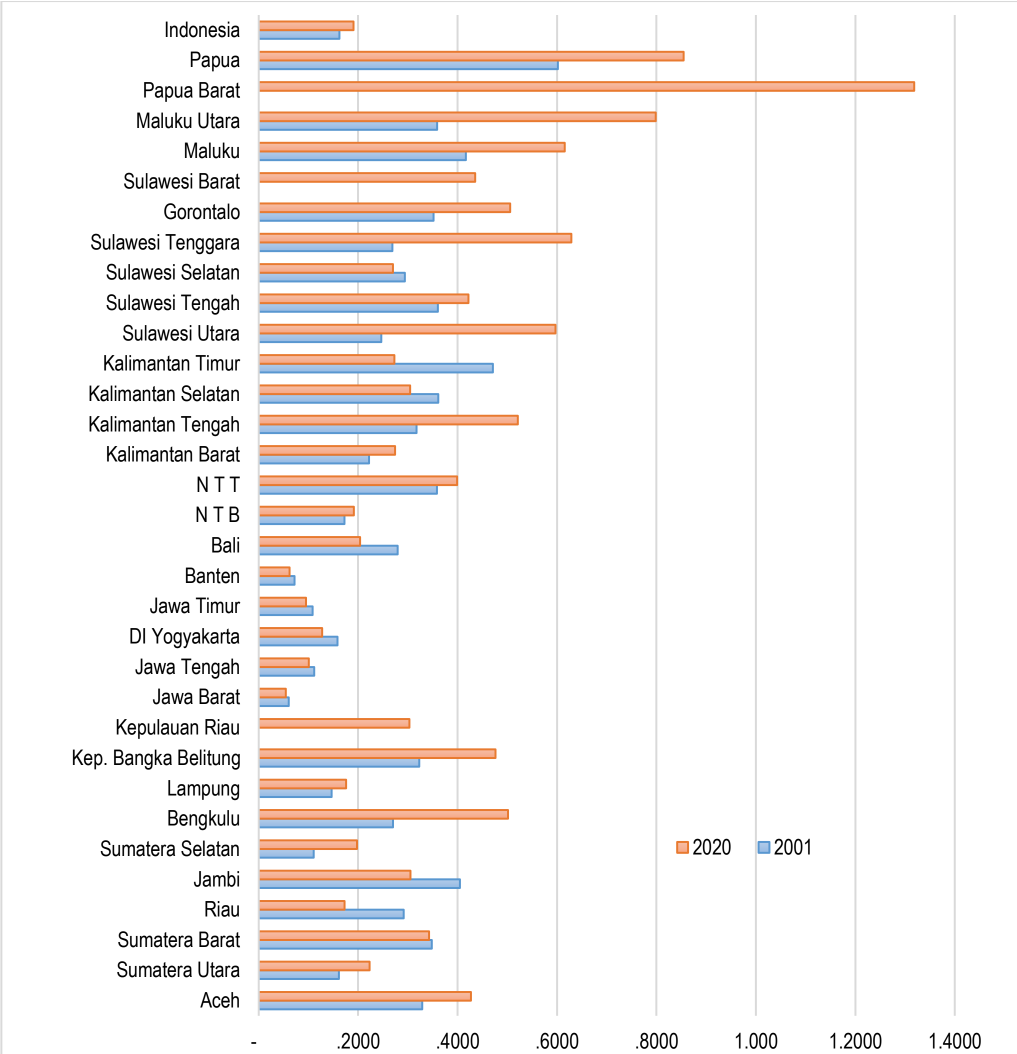

Figure 1. Level of Fragmentation Province in Indonesia in 2001 and 2020
Source: Author's calculation

The term fragmentation refers to a condition wherein an area there are many local government units, both in absolute and relative terms, which are standardized by population or area size. The opposite condition, where there is a small number of local governments, even in extreme conditions, only one local government controls the entire area, is identified as a consolidated structure (Boyne, 1992).

The choice of a fragmented or consolidated government structure is related to the government's responsiveness to people's preferences and the efficiency of the provision of public goods. The classical theory of public goods identifies a tradeoff between economies of scale and the cost of heterogeneity. Policymakers are faced with obtaining economies of scale from providing centralized public goods, where the average cost of supplying goods will decrease when production is increased. On the other hand, there is a tendency for people's welfare will be more significant when the provision of public goods is adjusted to their individual preferences. -each citizen (Alesina & Spolaore, 1997) ; (Cantarero & Perez, 2012); (Gómez-Reino & Martinez-Vazquez, 2013). The proper government structure will ensure the availability of public services that meet people's preferences while being provided at the correct cost.

Boyne (1992) identifies this structure into three effects: technical, competitive, and political. Engineering effects include economies of scale and economies of scope. If economies of scale are essential in providing local public goods, then a consolidation structure is more desirable than a fragmentation structure. The competition effect requires a fragmentation structure so local governments are more responsive and efficient. Political effects also require Fragmentation, so people's supervision and control over local government is better than before.

Nelson & Foster (1999) classify this difference as the views of Polycentrists who support Fragmentation and Centrists who advocate consolidation. According to Polycentrists, a system with more local governments provides a greater possibility of finding a match between services and the taxes that must be paid (Oates, 1999; Nelson & Foster, 1999; Hendrick et al., 2011). The closeness between taxpayers and the services obtained can create a fiscal balance or fiscal equivalence and reduce fiscal illusion (Bish, 2001). Fragmentation can also increase public access to appropriate price information for a public service and the various service models provided. Because bureaucrats no longer have a monopoly on service charge information, requests for excessive budgets beyond the need to meet societal demands become unjustified (Schneider, 1986).

Large-scale governance causes people to be further away from government offices and reduces the ability to control the accountability of their chosen officials (Grassmueck & Shields, 2010). With smaller authorities, there is a closer relationship between what citizens pay and the services they get, and they tend to limit demand. On the other hand, in more significant authorities, there is a tendency for fiscal illusions to emerge where citizens demand additional services for a particular place while the wider area pays for it, the cumulative effect of which leads to higher costs to local authorities (Bish, 2001; Jin & Zou, 2002; Callanan et al., 2014). In addition, large governments tend to adjust the "*tailoring of services*," less flexible, more bureaucratic, and less knowledgeable about local conditions (Vries, 2013)

On the other hand, opponents of Fragmentation argue that public goods and services substantially have economies of scale and scope, making them most efficient for large populations, compared to Fragmentation which cannot take advantage of this due to limited production scale. A consolidated government structure is desirable because it can capture the efficiency of economies of scale and the potential for agglomeration, overcome externalities, encourage fiscal equality, and is more efficient in coordination and planning of land or facility use (Grassmueck & Shields, 2010; Nelson & Foster, 1999). Consolidation can reduce bureaucratic overlap, inconsistent and confusing rules, and transaction costs and ultimately increase government efficiency (Grassmueck & Shields, 2010; Nelson & Foster, 1999). Consolidated structures can make greater use of human, material, and financial resources and offer a more comprehensive range of services to citizens and businesses than government systems that are fragmented into small units and limited resources (Grassmueck & Shields, 2010)

Fragmentation also has the potential to cause a separation between needs in the city center/government from resources in the suburbs so Fragmentation can exacerbate structure and poverty. Fragmentation can create more externalities or spillovers between government regions (Hendrick et al., 2011). In the case of positive externalities, public goods, and services are likely underprovided or provided below the required level because all governments expect benefits from being stowaways (free riders). Thus, more than the provision of public goods and services is needed to meet the demands and needs of the people in the region. In the opposite case (negative externality), the provision of public goods and services becomes larger (over-provided) because the costs that arise are not recognized by the regional authorities (Ronald J Oakerson & Park, 1989). In this perspective, government structures of Fragmentation and decentralization tend to be less efficient and cost more.

From various empirical studies related to the Leviathan hypothesis, there are differences in the main variables used as arguments in seeing the effect on the size or efficiency of government. Several studies use fiscal decentralization variables such as studies Crowley & Sobel (2011), Golem & Malešević Perović (2014), Maličká (2016), Thanh, S.D., Canh (2019), Qiao et al., (2019) and Choudhury & Sahu (2023). Meanwhile, other studies use fragmentation variables such as Schneider (1986), Dolan (1990), Nelson & Foster (1999), Dowding & Mergoupis (2003), Grassmueck & Shields (2010), Hendrick et al., (2011), and (Goodman, 2015). Campbell (2004) and Choudhury & Sahu (2022) use these two variables and add overlapping jurisdiction in evaluating government size.

The study of Oates (1985) became a pioneer in seeking empirical evidence for the Leviathan hypothesis. The study's results failed to find a significant relationship between fiscal decentralization and government size. Likewise, Nelson M (1986) study found no supporting evidence for the relationship between the two. Cassette & Paty (2010) concluded that tax autonomy would reduce central government spending in the long term, but on the other hand, it will increase regional government spending, thereby increasing aggregate public spending. However, Brülhart & Jametti (2019) still find that tax competition can be a way to increase welfare by limiting the scope for public sector revenue maximization.

In a series of interrelated previous studies, Marlow (1988), Grossman (1989), and Joulfaian David (1990) provide evidence in support of the Leviathan hypothesis. All three conclude that fiscal decentralization has limited government spending. Golem (2010) argues that the differences in study results mainly lie in two aspects: the level of analysis and the focus of measurement. Where Oates (1985) and Nelson M (1986) investigate at the central government level (state) and focus on the revenue side (tax revenue). At the same time, Marlow pays attention to the total size of government (central and regional) and focuses on the expenditure side (expenditure).

Furthermore, Golem & Malešević Perović (2014), Qiao et al., (2019), and Thanh, S.D., and Canh, (2019), found a negative relationship between fiscal decentralization and government size. Fiscal decentralization brings competition between local governments, reduces fiscal illusions, and increases overall government transparency, reducing the potential for wasteful and excessive spending. Crowley & Sobel (2011) find evidence that fiscal decentralization creates high competition among local governments and encourages lower tax rates.

Other empirical literature that focuses on government fragmentation structures, among others, is by Schneider (1986), who concludes that Fragmentation will promote efficiency and limit local governments from excessive growth. Fragmentation can slow the development of local government spending and service levels. Grassmueck & Shields (2010) also shows that regions with relatively fragmented governments have relatively strong economic performance. Nonetheless, the study by Dowding & Mergoupis (2003) found no evidence of a positive effect of regional government fragmentation on efficiency. A smaller government sometimes leads to more community satisfaction than a larger one. Nelson & Foster (1999), getting high Fragmentation will reduce per capita income growth. Fragmentation can also increase government costs (Dolan, 1990; Goodman, 2015).

This study aims to analyze whether the regional expansion policy and massive fiscal decentralization in Indonesia can suppress excessive increases in government spending, as stated in the Leviathan hypothesis. The existence of competition in a fragmented government structure and decentralization policies should encourage regional governments to act efficiently and competitively, which will reduce the growth rate in the size of local governments. This research contributes to the development of science by finding empirical evidence regarding the validity of the Leviathan Hypothesis in the policy of regional expansion and fiscal decentralization in Indonesia.

METHODS

This study analyzes whether the Leviathan hypothesis applies to Indonesia's regional expansion policies and fiscal decentralization. In this perspective, the regional expansion policy as the central aspect of changing the structure of government fragmentation and fiscal decentralization policies will create a competitive climate among local governments. They can further limit the development of the size of the regional government, which is identified based on the share of total local government spending on Gross Regional Domestic Product (GRDP). The model used to estimate the effect of government fragmentation and fiscal decentralization on Local Government Size in Indonesia is as follows.

$$GOVSIZE_{it} = \alpha_0 + \alpha_1 FRAG_{it} + \alpha_2 DF_{it} + \alpha_3 GRDPCAP_{it} + \alpha_4 GINI_{it} + \alpha_5 POVERTY_{it} + \alpha_6 POP_{it} + \alpha_7 OPENNESS_{it} + \mu_{it}$$

GOVSIZE is a measure of regional government as measured by the share of local government spending on regional GDP. FRAG is Fragmentation, measured relatively based on the number of local governments in one province per 100,000 population. One of the reasons for standardizing the use of population is the study by Gómez-Reino & Martinez-Vazquez (2013), who found that population size has a stronger correlation with Fragmentation in a region compared to geographical areas. Another fragmentation measure, fiscal dispersion, is measured using the Hirschman-Herfindahl index (HHI). This measure was used by Goodman (2015), Hendrick et al. (2011), and Grassmueck & Shields (2010). However, the study used relative Fragmentation weighted by population for the current analysis. The fragmentation variable was calculated based on the time of formation. The New Autonomous Region (DOB) has absolute authority through a separate Regional Revenue and Expenditure Budget (APBD). GINI is income distribution inequality, GRDPCAP is the income per capita, POP is the total population, and OPENNESS is the ratio of exports + imports to GRDP. At the same time, DF is a fiscal decentralization variable that uses the revenue side (DFREV) and expenditure (DFEXP).

The study uses panel data, a combination of cross-section data and time series data, covering 32 provinces in Indonesia during the 2002-2020 period. The DKI Jakarta and North Kalimantan provinces were excluded from the data because the districts/cities in the DKI province do not have autonomous rights and are an integral part of the provincial government. Mayors and Regents in DKI Jakarta Province are not directly elected by the community as in other districts/cities but are determined directly by the Governor. Meanwhile, North Kalimantan Province was not involved because it was only formed in 2013. Data sources were obtained from the Central Statistics Agency (BPS) and several other relevant agencies, mainly through www.bps.go.id and www.djpk.depkeu.go .id.

Regarding panel data, at least three analytical techniques can be used: Pooled Regression, Fixed Effect Model, and Random Effect Model (Gujarati & Porter, 2009; Greene, 2012). Formal tests were carried out to obtain an appropriate estimation technique for using panel data, namely the F test and Hausman test. The test results show that the Fixed Effect Model is more appropriate for estimating existing relationships. Furthermore, estimation is also carried out in several equation models to obtain robust results, including the fiscal decentralization variable on the revenue and expenditure sides. The use of panel data in this study is an advantage in itself. Most previous studies used more cross-sectional data because the number of local governments in a jurisdiction has mostly stayed the same. However, in the case of Indonesia, the rapid change in the number of local governments since the reform era provides enough information to explore the effect of Fragmentation on local government size.

RESULTS AND DISCUSSIONS

Table 1 shows the results of descriptive statistics, where the number of observations is 597 samples. The average value of government size is 14.54, with the highest contribution of government spending to GRDP at 43 percent in Maluku Province and the lowest at 3.03 percent in Riau Province. Meanwhile, the average fragmentation value is 0.39, with a maximum value of 1.53 in West Papua and the lowest fragmentation value of 0.05 in West Java. For fiscal expenditure, the average is 2.00, with the highest degree of fiscal decentralization at 10.14 in East Java and the lowest in North Maluku Province. Furthermore, the average value of income decentralization was 1.51, with the highest degree of decentralization being 7.48 in West Java Province and the lowest in West Sulawesi. Overall, this can be seen in Table 1 below.

Table 1. Statistic Descriptive

Variable	Mean	Median	Max	Min	Std.Dev.	Skewness	Kurtosis	Obs
GOVSIZE	14.54	13.06	43.27	3.03	7.84	0.92	3.67	597
FRAG	0.39	0.35	1.53	0.05	0.26	1.53	6.29	597
GRDP_CAP	17.03	16.96	18.72	15.84	0.54	0.79	3.79	597
GINI	0.34	0.34	0.46	0.24	0.04	0.10	2.39	597
POVERTY	14.53	12.80	41.80	3.78	7.82	1.04	3.79	597
POP	15.22	15.12	17.72	13.40	0.99	0.75	3.20	597
OPENNES	89.73	80.30	328.52	9.70	45.69	1.85	9.23	597

DF_EXP	2.00	1.37	10.14	0.26	1.80	2.14	7.82	597
DF_REV	1.51	1.03	7.48	0.19	1.35	2.10	7.50	597

Source: Calculation on Eviews

The results of the research data analysis can be seen in Table 2. The estimation results for all models consistently find no evidence of the validity of the Leviathan hypothesis in the policy of regional expansion and fiscal decentralization in Indonesia. Even the results of the study show that Fragmentation has a significant positive effect on local government size in Indonesia. The large number of new regional formations indicates a higher level of Fragmentation and increases the local government size. With a fragmented structure, the share of regional spending in GRDP has increased markedly. The expected competitive climate in the fragmentation structure that will suppress government spending, as stated in the Leviathan hypothesis, does not occur. The fragmentation structure makes the size of the regional government even more extensive.

Table 2. Estimation effect fragmentation on local government size in Indonesia

Dependent Variable: Government Size						
Method: Panel EGLS (Cross-section weights)						
	DF REVENUE			**DF EXPENDITURE**		
	OLS	**FE**	**RE**	**OLS**	**FE**	**RE**
C	238.5286***	201.2569***	203.1971***	239.254***	205.865***	209.2984***
	(21.78238)	(10.46232)	13.97959	(22.22084)	(10.79902)	14.62187
FRAG	9.748538***	3.420161*	10.44203***	9.730819***	3.443477*	10.44163***
	(8.510623)	(1.811389)	7.254325	8.549257	1.841109	7.288124
GRDPCAP	-10.00512***	-11.40236***	-9.483279***	-10.02141***	-11.75577***	-9.696719***
	-(22.25479)	(-12.31314)	-13.69526	-22.51422	-12.87679	-14.13899
GINI	29.78336***	-7.170317	3.484050	29.74799***	-7.371821	3.194626
	(6.921809)	(-1.462291)	0.840070	6.933286	-1.512154	0.774554
POVERTY	-0.030966	-0.587585***	-0.379806***	-0.030922	-0.582808***	-0.383203***
	(-1.030458)	(-8.679902)	-9.134988	-1.031015	-8.747144	-9.254091
POP	-4.600883***	0.990446	-1.886931***	-4.631078***	1.040503	-2.067704***
	(-10.49229)	(1.166351)	-3.553767	-10.80255	1.234762	-3.952998
OPENNESS	0.003689	0.013432***	0.011012**	0.003635	0.014267***	0.011672***
	(0.983261)	(3.549197)	2.522283	0.971185	3.797150	2.694569
DFREV	1.651180***	0.571844**	0.553935**			
	(7.562591)	(2.506668)	1.990996			
DFEXP				1.262078***	0.712919***	0.605857***
				7.919205	4.314167	3.059163
R-squared	0.729789	0.895583	0.278784	0.731104	0.896871	0.283570
Adjusted R-squared	0.726577	0.888472	0.270213	0.727909	0.889848	0.275056
S.E. of regression	4.101595	2.619549	2.856330	4.091596	2.603346	2.843329
F-statistic	227.2536	125.9466	32.52524	228.7774	127.7026	33.30465
Prob (F-statistic)	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
Observations (N)	597	597	597	597	597	597
Prob. Hausman Test			0.0000			0.0000

Note: Calculation on Eviews. t -statistics in parentheses. (*) indicates statistical significance at the 10% level, (**) at 5%, and (***) at 1%.

This result contrasts with the study of Schneider (1986), who concluded that Fragmentation promotes efficiency and restricts local governments from excessive growth. Schneider's conclusion that the competition inherent in the fragmentation structure will slow down the development of regional government spending and service levels cannot be found in the case of regional expansion in Indonesia. It seems to enrich the findings Maličká (2016) that the effect of fiscal decentralization to limit leviathan is still weak. Likewise, the study Choudhury & Sahu (2023) found that the impact of fiscal decentralization on government size was negative at the lower quantiles due to competition between jurisdictions, while at the middle and upper quantiles, the impact was positive due to the efficiency hypothesis. Therefore, according to Choudhury and Sahu (2023), refining the methodology and socio-political transmission channels in explaining the unclear relationship between fiscal decentralization and government size is necessary.

In line with the effect of Fragmentation, the fiscal decentralization variable also shows a significant positive relationship with local government size, both on the income side (df_rev) and the expenditure side (df_exp). Fiscal decentralization policies increase the size of local governments. Thus, the existence of the Leviathan hypothesis cannot be found in the fiscal decentralization policy in Indonesia. The argumentation of Oates (1985) and Nelson M (1986), which states that decentralization will limit government spending, actually does not occur in Indonesia. This result is very different from most of the previous studies, such as Qiao et al., (2019), Thanh, S.D., Canh, (2019)**,** Marlow (1988), Grossman (1989), and Joulfaian David (1990), which provide evidence supporting the Leviathan hypothesis. Likewise, a study (Golem & Malešević Perović, 2014) found a negative relationship between fiscal decentralization and government size. Fiscal decentralization brings competition between local governments, reduces fiscal illusions, and increases overall government transparency, reducing the potential for wasteful and excessive spending. Crowley & Sobel (2011) find evidence that fiscal decentralization creates high competition among local governments and encourages lower tax rates.

One of the causes of fiscal decentralization's failure to suppress government spending growth is that fiscal decentralization in Indonesia relies heavily on fiscal transfer schemes. Regional revenues depend on financial assistance/transfers from the central government, especially the General Allocation Fund (DAU). At the same time, the role of Regional Original Revenue (PAD) which reflects actual governance, still needs to be expanded. Until 2020, the portion of Regency/Municipal PAD to Regional Revenue is still around 13.48 percent, while the portion of balancing funds in aggregate regional revenues reaches 57.09 percent, Other legitimate income is 20.66 percent, and Financing Receipts is 8.77 percent (Badan Pusat Statistik, 2022). In this context, Shadbegian (1999) and Jin & Zou (2002) find that intergovernmental transfers and vertical inequality have increased overall government spending and spending at each level of government. Thus justifying collusion between different levels of government and weakening the ability to discipline fiscal federalism. Fiscal decentralization may not lead to a leaner public sector due to the "flypaper effect" and "problems of the commons" (Jin & Zou, 2002). Rodden (2003) and Golem (2010) unequivocally state that if the effect of decentralization is to constrain the size of government, then decentralization must be implemented on both sides, decentralizing spending and revenue. If not, the shared pool problem might increase and reduce pressure on local government competition to mobilize economic resources.

The estimation results for the control variable also show good results. Variable poverty has a significant negative effect. Higher poverty will reduce the size of local government. The income per capita also has a significant negative effect, as the study found (Golem & Malešević Perović, 2014). Meanwhile, the Openness variable proved to have a significant positive effect. A greater level of economic openness will increase local government size in Indonesia. These results are pretty different from the studies of Cassette & Paty (2010) and Golem & Malešević Perović (2014), which obtained opposite results. Furthermore, the variables Inequality (GINI) and population (POP) have not proven significant in driving the size of government in Indonesia.

CONCLUSIONS

The regional expansion policy and fiscal decentralization in Indonesia have yet to be proven to reduce the size of regional governments significantly. This policy has consistently caused the size of local governments to grow bigger. The expectation of a competitive climate that will reduce the rate of government size in the Leviathan hypothesis cannot be found in these two variables. There are various reasons behind the failure to find the Leviathan hypothesis, among others, because political interests generally cause the formation of new regions in Indonesia, so it is financially and economically inefficient. Several studies also show that the performance of new autonomous regions is not very satisfactory, where the average economic growth rate in newly created regions is lower than that of parent regions, and the benefits of forming new autonomous regions are still far from the expected promises and expectations.

Fiscal decentralization policies have also yet to be able to suppress government spending or create government innovation and efficiency in providing services to the community. Dependence on central transfers and an imbalance between the decentralization of revenues and expenditures are allegedly the main contributing factors. Dependence on central transfers results in fiscal illusions or problems of the common, which encourage the size of the government to get bigger and fail the Leviathan hypothesis.

This research implies that to create government efficiency and economic performance from the process of regional expansion in Indonesia; it is necessary to consider regional potential. Besides that, it also needs the right strategy for local governments to increase regional independence through improving the quality of human resources and excavation, mapping, and optimal utilization of regional potential.

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