*JEMSI (Jurnal Ekonomi, Manajemen, dan Akuntansi)*
*E-ISSN: 2579-5635, P-ISSN: 2460-5891*
*Volume 10 (1) Februari Tahun 2024, Hal 32-38.*

# Analysis Of The Influence Of Minimum Wages, Central-Regional Transfer Cost Allocation And Fiscal Decentralization On Regional Income Inequality

Indra Ismayudi Tanjung
Prodi Ekonomi Pembangunan, Universitas Teuku Umar, Indonesia
tanj.indra@gmail.com

Rahmat Al Hidayat
Prodi Ilmu Administrasi Bisnis, Sekolah Tinggi Ilmu Administrasi Bengkulu, Indonesia
yynrahmad@gmail.com

Sugeng Karyadi
Prodi Administrasi Publik, Universitas Lambung Mangkurat, Indonesia
sugeng.karyadi18@gmail.com

Lalang Saksono
Prodi Manajemen, Universitas Islam Djakarta, Indonesia
lalangsaksono@yahoo.com

Odih Sumirat
Prodi Ilmu Administrasi Negara, STIA Menarasiswa, Indonesia
odihsumirat@gmail.com

**Article's History**:
Received 3 January 2024; Received in revised form 15 January 2024; Accepted 28 November 2024; Published 1 February 2024. 

**Suggested Citation:**
Tanjung, I, I., Al Hidayat, R., Karyadi, S., Saksono, L., & Sumirat, O. (2024). Analysis Of The Influence Of Minimum Wages, Central-Regional Transfer Cost Allocation And Fiscal Decentralization On Regional Income Inequality. JEMSI (Jurnal Ekonomi, Manajemen, dan Akuntansi). JEMSI (Jurnal Ekonomi, Manajemen, Dan Akuntansi), 10 (1). 32-38. https://doi.org/10.35870/jemsi.v10i1.1890

**Abstract:**

In any nation, income disparity is a crucial issue for development. The disparity in income distribution is the primary cause of income inequality. The increasing income disparity is a sign of the growing inequality in the allocation of income in society. The authors of this study aim to investigate how income inequality is affected in the regencies and cities of one of provinces minimum wage in Indonesia, central-local transfer cost allocation, and fiscal decentralization. The Fixed Effect Model (FEM) approach is used in this study's panel data analysis. The author's analysis indicates that while there is no significant association between income inequality and fiscal decentralization, there is a substantial relationship between income inequality and the allocation of central-regional transfer costs and the minimum wage. Income inequality is significantly impacted by fiscal decentralization, minimum wage, and central-regional transfer cost allocation.

**Keywords:** Income, Minimum Wage, Fiscal Decentralization, Transfer Cost

## Introduction

Generally speaking, the primary objective of every nation on the planet is to increase the standard of living or communal welfare through economic growth. Put differently, economic development refers to a nation's endeavors to enhance the well-being of its citizens by utilizing its current resources. A high rate of economic growth or an annual rise in the national income are two indicators of increased prosperity. Furthermore, according to

Todaro and Smith, economic growth seeks to raise income equality and enhance people's welfare. The degree of income inequality is frequently used to assess if a development program is being implemented successfully. It is still challenging to attain local population wellbeing through economic growth. Even today, there is a common perception that the economic welfare resulting from income equality is not equitable. Consequently, the issue of economic disparity has emerged as a significant concern for several nations worldwide, particularly emerging nations such as Indonesia. By distributing income equally, society can have a higher standard of living (Anshari et al., 2019).

Disparities in the distribution of income are the source of income inequality. This could happen as a result of variations in each person's production, where one person or group is more productive than another. A measure of how people's income is distributed in a region or area during a specific time period is called income inequality. In Indonesia, there is an increasing tendency in income disparity at the national, urban, provincial, and rural levels. Disparities in the potential of natural resources, variations in the caliber of human resources, and inadequate infrastructure and facilities are a few of the elements that contribute to economic inequality. Because of this, certain emerging regions are unable to benefit from the current and upcoming development process. Tarigan's growth pole theory explains that while slum regions would persist, a region with more growth poles will be able to equalize its income distribution and lower levels of inequality. But when new economic growth poles continue to expand, the number of slums will eventually decline (Hatmawan et al., 2022).

The State Budget Law of Indonesia specifies a number of development goals that the Indonesian government must annually meet, one of which is the disparity of income distribution as measured by the Gini coefficient. One model used to gauge the level of income disparity in the population is the Gini coefficient. An area's degree of inequality, or the unequal distribution of income between high- and low-income earners, is indicated by a region's higher Gini coefficient. Todaro and Smith contend that excessive income disparity is perceived as unjust by the public, particularly those in the lower middle class, and can result in economic inefficiencies as well as harm to social cohesion and stability. The Special Region of Yogyakarta has the greatest inequality value among the ten provinces (Tanjung, 2020).

The regencies and cities that make up some province have an impact on income disparity in the province. The Province's gini coefficient value will be impacted by a high Regency or City gini coefficient value, and vice versa. The Central Bureau of Statistics published statistics on Gini coefficient, and the data indicates that the value of the Gini coefficient grew in this province. This suggests that income disparity has increased throughout this province's regencies and cities. Indicating that the government in this province is still unable to consistently reflect the ability to run the government and manage regional finances so that ultimately it is unable to reduce income inequality, the Gini coefficient value in the Regency / City in this province is still fluctuating and even tending to increase. In order to lower income disparity, collaboration between the provincial and regency/city governments is necessary. This will help this province move up from its current ranking of 10th out of 34 Indonesian provinces by lowering its Gini coefficient (Akmal et al., 2023).

The issue of income disparity needs to be addressed right away. Implementing regional autonomy through fiscal decentralization is one strategy used to combat regional income disparity. The division of power between the federal government and local governments—along with the transfer of financial resources to support regional affairs—is the result of the fiscal decentralization policy's execution. It is anticipated that fiscal decentralization would enable impoverished areas to improve their economies to the point where the public can see the benefits and lead more prosperous lives. Furthermore, a primary goal of fiscal decentralization—the process by which regional authority is granted—is to serve as a bridge to address welfare issues. This indicates that policies are implemented through a combination of top-down and bottom-up approaches to development. In recent decades, decentralization has emerged as one of the most popular public finance reforms in emerging nations. Local governments are supposed to independently investigate their revenue source and use local expenditure for development as part of the fiscal decentralization program (Silamat et al., 2023).

Fiscal decentralization promotes long-term economic growth and development by improving public sector efficiency. Local governments are able to efficiently provide public services that meet the demands and preferences of the public while also being well informed and well-versed in the resources available to them. Fiscal decentralization is being implemented as part of a development plan aimed at improving macroeconomic stabilization and growth. Political, administrative, and fiscal decentralization are the three categories of decentralization. Fiscal decentralization is the transfer of power and management from the national level to the local level. This includes the entire range of regional spending matters as well as a portion of the local tax and levies collection authorities. At the district/city government level, the transition from centralization to decentralization has had a significant effect on budgetary management. The central government's ability to influence local governments has decreased as a result of the implementation of fiscal decentralization. in order to provide local governments more autonomy to develop their own areas without being constrained by national regulations (Canare et al., 2020).

Through the regional budget, local governments may control growth, guarantee its continuation, raise the standard of living for residents, and lessen economic disparities throughout areas. The involvement of local governments in managing central government transfers in the areas of social and economic development, such as labor-intensive programs, and budget allocation are key factors influencing the success of regional economic development. One of the main priorities of national development goals has always been economic development. Local governments become more reliant on the federal government as a result of the granted autonomy. This is also true in Indonesia, more precisely, every area is financially dependent on the national government. The transfers from the center to the regions are intended to guarantee that public services are provided and government operations are carried out in the regions in accordance with established guidelines. Although the transfer of funds from the central government to the regional government is meant to bridge the budgetary gap between the two, practically every region—districts and cities alike—becomes dependent on the funds from the center during this process (Hardinandar, 2020).

Wages are frequently linked to income inequality, in addition to fiscal decentralization and the distribution of central-regional transfer costs. The government has established minimum wage regulations in an effort to lessen inequality. This salary acts as a disincentive to income disparities or distribution among labor-like workers who lack the necessary abilities to get by. Wages and income are further indicators of the welfare of the community. Inadequate compensation for labor leads to economic inequality. Individuals who have entered the workforce desire to get salaries that are really prosperous for their standard of living. Pay is a major factor in raising working class people's standard of living. All members of the working class might theoretically be guaranteed a more successful living under the wage system (Ridho & Wijayanti, 2022). This study aims to determine the effect of fiscal decentralization, central-local transfer cost allocation and minimum wage on income inequality.

## Literature Review

Public finance, according to Richard A. Musgrave, is the study of the government's overall economic operations. Public finance is the study of how the government uses money to pay for its operations, much like Carl C. Plehm believes. As a result, according to the definition given above, the phrases state finance, public economics, and public sector economics are identical with public finance. According to Harvey S. Rossen, public finance is an area of economics that studies government expenditure and taxation (Wong, et al., 2021). While financial concerns are covered, the primary focus of public finance research is on actual resources rather than financial issues per se. Both normative and positive analysis are used in the study of public finance. Normative analysis concentrates on ethical concerns in public finance, whereas positive analysis stresses cause and effect issues. According to Harvey S. Rossen, contemporary public finance is connected to the government's microeconomic operations, including how it manages and controls the distribution of income and the distribution of resources (Silamat et al., 2023).

The Neo-Classical Hypothesis put forward by Kuznets provides the theoretical framework for interregional income disparity. This hypothesis explains why an inverted U-curve represents the relationship between inter-regional income disparity and national economic progress. Inequality is more common in the early phases of a nation's growth. The process keeps going until there is a peak in income disparity. After that, as development proceeds, inequality will progressively decrease. According to Sjafrizal, a few of the main causes of inequality between regions are variations in the composition of natural resources, variations in demographics, a lack of easy mobility for goods and services, a concentration of regional economic activity, and the distribution of funds for regional development (Tanjung, 2020).

When a government disregards property rights, ethnic diversity, and the degree of progress all contribute to income inequality, society's share of revenue is uneven. One cannot divorce the Gini ratio from income inequality. The Gini Coefficient is a metric used to assess the general degree of income inequality, according to BPS. The Gini coefficient ranges from 0 to 1, where higher values indicate greater income disparity in a certain location and vice versa. A place with a Gini index of zero indicates complete income equality or no income inequality at all. The relative level of living throughout society as a result of geographical differences in the resources and inputs of production is referred to as inequality (Akmal et al., 2023). The Central Bureau of Statistics defines income disparity as the difference in total income earned during a specific time period from both the official and informal sectors. Additionally, income disparity frequently refers to the fact that the rich's actual income is rising while the poor's is falling. This indicates that the rich's actual income is increasing more quickly than the poor's. There are at least six factors that contribute to inequality, according to Adelman and Morris. These factors include high population growth, which lowers per capita income, higher inflation, more capital investment than labor investment, low social mobility, a lack of regional or national demand-supply elasticity, and the ongoing decline in small businesses like MSMEs (Canare et al., 2020).

Fiscal decentralization is a concept in governance that refers to the transfer of fiscal responsibility from the central government level to the regional or local government level. It involves the allocation of financial resources, including revenues and expenditures, to local authorities to provide greater authority for economic and development decision-making at the local level. Fiscal decentralization usually includes the assignment of responsibilities related to development planning, budget management, and implementation of public programs. The benefits of fiscal decentralization can vary depending on a country's political, economic, and social context. One of the main benefits is the empowerment of regions to better manage their local resources according to the needs and priorities of local communities (Anshari et al., 2019). By giving authority to local governments, fiscal decentralization can improve government accountability and responsiveness to citizens' needs. On the other hand, fiscal decentralization can also pose challenges. One of them is the ability of local governments to manage their finances well. To address this, it is important to ensure that local governments have adequate administrative and financial capacity. In addition, there needs to be an effective monitoring and evaluation mechanism to ensure that resource allocation is done efficiently and effectively (Hatmawan et al., 2022).

In the global context, many countries have implemented fiscal decentralization as part of efforts to enhance local development and reduce regional disparities. However, the implementation of fiscal decentralization often involves complex policy reforms and changes in governance systems. Therefore, it requires strong commitment from both central and local governments as well as public support to achieve success in implementing fiscal decentralization (Tanjung, 2020). In some cases, fiscal decentralization can also be the key to enhancing economic growth and sustainable development. By giving more authority to local governments, local innovation can be enhanced, and policies that better suit the needs of the people can be implemented. However, it is important to remember that fiscal decentralization is not a single solution to all problems, and needs to be balanced with the principles of sustainability, equity, and efficiency (Hardinandar, 2020).

The agency theory put forward by Jensen and Meckling serves as the theoretical foundation for the distribution of central-regional transfer expenses. According to agency theory, a contract or agreement is made between two parties: the party creating the policy, also known as the agent, and the party receiving it, also known as the principal. In this instance, the agents tasked with formulating policies meant to promote economic growth and lessen income disparity are the principals who accept policies from the government. Following the passage of Laws, local governments have the authority to handle their own budgets. Funds designated for regional needs are obtained from APBN income and are known as balancing funds. Reducing the fiscal imbalance between the federal government and local governments is the goal of the Balancing Fund. Along with aiding in the execution of local government authorities to accomplish the goals of offering the regions autonomy. Each year, the state budget establishes how much money each region will get in balancing funds (APBN) (Ridho & Wijayanti, 2022).

Gregory Mankiw's proposal for pay efficiency serves as the theoretical foundation for the minimum wage. According to the wage efficiency principle, greater employee compensation will result in higher levels of productivity at work. Workers will be able to meet their necessities thanks to the high earnings offered. The more evenly workers are paid, the less income disparity there will be in the community, which will help to lower inequality at the regional, provincial, and federal levels. Wages are the entitlement of employees to compensation from their employers, which is defined as monetary value and is decided upon and paid in accordance with a labor agreement. The amount of work also affects how much is paid. The wage method is frequently connected to a framework. The system in question is a long-term rule approved by a central authority with the goal of preserving equity and stability in providing for the necessities of life (Akmal et al., 2023).

## Methodology

This study employs an associative research design and a quantitative methodology. Secondary data from BPS is used to collect the data. The subject of this study in one of provinces in Indonesia. The small number of locations meant that saturated sampling was the method utilized to choose the study sample. The analytical test employed a multiple regression analysis model. The data was analyzed using the Eviews 12 software, and the outcomes were shown using descriptive analysis.

## Results

According to the Jarque-Bera normality test findings, the probability value is 0.11, which is higher than the significance threshold of 0.05. This demonstrates the normal distribution of the data in this study model. The tolerance value of all independent variables more than 0.1 and the VIF value of all independent variables 10 are known properties based on multicollinearity. Thus, it can be inferred from the preceding computations' findings that the regression equation model is suitable for application in this investigation and does not have a multicolonierity issue. The model in this study is not subject to heteroscedasticity issues since the Prob. chi-squared value is larger than the significance threshold of 0.05, according to the findings of the heteroscedasticity test using the Breusch-Pagan-Godfrey test. Then in the autocorrelation test using the Breusch-Godfrey serial correlation LM test, the Prob. chisquared value is greater than the 0.05 significance level, this means that the model in the study is free from autocorrelation problems.

The regression analysis explains why the fiscal decentralization variable (DF) has a coefficient value of 0.2 and a t-statistic probability value of 0.14, exceeding the significance level of 0.05. In summary, H0 is supported and H1 is opposed, indicating that the impact of fiscal decentralization on income inequality is negligible. The central-regional transfer cost allocation variable (ABTP-D) has a coefficient of -0.25 and a t-statistic probability value of 0.03, which is less than the significance threshold of 0.05. We find that there is a considerable impact of central-regional transfer cost distribution on income inequality, with H0 being rejected and H1 accepted. The minimum wage variable (UM) has a coefficient of -0.04, a t-statistic probability value of 0.01, and is less than the significance level of 0.05. We may conclude that the minimum wage significantly affects income disparity since H0 is rejected and H1 is accepted.

The probability value (F-statistic), based on the panel data regression findings, is known to be 0.000. Thus, H0 is rejected and H1 is accepted. It may be inferred that the variables of minimum wage, fiscal decentralization, and central-local transfer cost allocation all significantly affect income inequality at the same time. The probability value is less than the significance level of 0.05. The results of the coefficient of determination test are likewise achieved with an Adjusted R-Squared value of 0.9 based on evaluating the regression equation. Thus, it can be said that the independent variables (minimum wage, central-regional transfer cost allocation, and fiscal decentralization) account for 90% of the variance in the dependent variable (income inequality) in this province, with the remaining 10% being influenced by variables not included in this study.

## Discussion

Because of the inadequate level of fiscal decentralization in the Regency / City in province, the study's results show a positive association between the fiscal decentralization and income inequality variables. And this demonstrates that local governments' performance in managing the region's potential is still not operating at its best. On the other hand, increased local revenue—a sign of growing fiscal decentralization—occurs when local government spending funded by sources of local revenue, such as taxes and levies and community income, rises. Therefore, it makes sense that as fiscal decentralization rises, government spending on public services would rise as well, enhancing community welfare and reducing economic disparity.

According to Francois Perroux's Growth Pole Theory, a region's income distribution will be more equitable the more growth poles it has, even though slum regions would still develop. But when new economic growth poles emerge throughout time, the number of slums will gradually decline. Economic development can only go as long as the economy is growing. Local governments have been granted fiscal decentralization because they are better able to understand the requirements of the community in relation to public goods. ... order for the public sector's spending to be properly allocated and, naturally, become more efficient, using revenue from the region. Infrastructure and education costs are included in the public sector's spending.

Those's income will rise as a result of improved infrastructure and education. Additionally, those who struggle to find job in metropolitan areas would benefit immensely from easier community mobilization, which will reduce unemployment and boost income. Individuals' spending will rise in tandem with their income, so contributing to economic growth. Due to the fact that community income and salaries are two factors that contribute to economic growth. The results of this study are consistent with Aditya's research, which shows that fiscal decentralization reduces income inequality in a positive but negligible way. This is due to the region's still-considered inadequate financial management; as a result, government initiatives to lessen economic disparity are not always fully implemented and budget allocation is not on target. Failure of the fiscal decentralization system might result from a number of possible factors. Institutions, in North's view, are what set social norms and boundaries for interaction. Setting limits in society is the responsibility of the government, which acts as a regulator to promote stability. Keynes postulated that in order to prevent inefficient and ineffective market mechanisms, government intervention measures are crucial.

The study's findings indicate that there is a negative correlation between the variable income inequality value of -0.02 and the variable allocation of central-regional transfer costs. Assuming other factors remain constant, income inequality will be impacted by a one percent rise in the central-regional transfer cost allocation variable by -0.02%. This inverse relationship arises because the central government continues to provide financial support for the fundamental initiatives aimed at reducing income inequality in the Regency or City of the province. These initiatives include public employment opportunities and education. The study's findings are consistent with those of Ridho and Wijayanti's research, which found that central transfers significantly and negatively affect income inequality as shown by the gini ratio value. By giving the regions balance monies made up of general allocation funds, special allocation funds, and revenue sharing funds with the goal of reducing economic disparity, Indonesia's decentralization program seeks to establish elements of regional independence. Additionally, income inequality in Indonesia will decline when local governments receive more balancing funds. However, for the regional economy to expand and thrive, local governments must allocate a greater portion of their personnel expenditures toward capital projects.

The findings of this study demonstrate that the minimum wage variable has a negative association to the income inequality variable with a value of -0.04. Assuming all other factors remain constant, a one percent rise in the minimum wage variable will result in a -0.04% impact on income inequality. Wages serve as a disincentive to income disparities or inequality among workers, such as laborers who lack the abilities to make ends meet, which is why there is a negative association between wages and inequality. Furthermore, income serves as a proxy for societal well-being.

The present study's findings are consistent with the research done by Riandi and Varlitya, which demonstrated that minimum wages had a noteworthy and adverse impact on income disparity. Because the value of money abilities declines year and the cost of products keeps rising, wages are more and more fragile. This condition explains why people with low incomes see a decline in their purchasing power because they do not have as much money to buy goods as they did before the prices of goods rose, while people with large or high incomes do not see a significant decline because they have enough money to buy goods even though the prices of goods have increased. The difference between the affluent and the poor has widened as a result. Nonetheless, the disparity or inequality is lessened with modifications to the minimum wage legislation or policy.

## Conclusion

The study's findings indicate that there is no discernible relationship between fiscal decentralization and income inequality; rather, a rise in fiscal decentralization will exacerbate income disparity. Income inequality is influenced by the Central-Regional Transfer Cost Allocation to a substantial extent; hence, a rise in this cost allocation is likely to result in a reduction in income inequality. Given that the Minimum Wage has a considerable impact on Income Inequality to a partial degree, raising it should result in a decrease in Income Inequality. Income inequality is significantly impacted by minimum wage, central-local transfer cost allocation, and fiscal decentralization all at the same time.

## References

Anshari, M., Azhar, Z., & Ariusni, A. (2019). Analysis of the Effect of Education, Provincial Minimum Wage and Capital Expenditure on Income Inequality Across Provinces in Indonesia. Ecogen Journal, 1(3), 494.

Hatmawan, A. A., Suhendra, N., Tanjung, I. I., Ningsih, L., & Arisna, P. (2022). Relevansi Peran Financial Literacy dan Proactive Market Orientation (PMO) Terhadap Kinerja Keuangan UKM. *INVENTORY: JURNAL AKUNTANSI*, *6*(2), 168-181.

Tanjung, I. I. (2020). *Analisis Faktor-Faktor yang Mempengaruhi Pengangguran dan Kemiskinan di Provinsi Sumatera Utara* (Doctoral dissertation, Universitas Sumatera Utara).

Akmal, S., Zulfikri, A., Al-Hidayat, R., & Sasmito, P. (2023). Tourist Perception of the Quality of MSME Products and Services in Tourist Destinations. *West Science Journal Economic and Entrepreneurship*, *1*(05), 48-54.

Silamat, E., Chusumastuti, D., Al Hidayat, R., Hadi, A. J., Sucipto, B., Rijal, S., & Pratomo, A. B. (2023). Pelatihan dan Strategi Pemasaran Inovatif untuk Meningkatkan Awareness Produk UMKM di Pasar Lokal. *Jurnal Pengabdian West Science*, *2*(04), 264-270.

Canare, T., Francisco, J. P., & Caliso, R. A. C. (2020). Decentralization And Income Inequality In A Panel And Cross-Section Of Countries. Journal Of International Development, 32(4), 543-579.

Hardinandar, F. (2020). The Role of Fiscal Policy on the Trade-Off Between Inequality and Poverty in Indonesia. Economic And Businessness, 16(1), 1-10.

Ridho, M. A. M., & Wijayanti, D. (2022). Analysis of the Effect of General Allocation Fund, Special Allocation Fund, Tax Revenue Sharing Fund, and Economic Growth on Income Inequality in Indonesia. Journal of Economic and Financial Policy, 1(1), 71-81.

Wong, S. W., Tang, B. S., Liu, J., Liang, M., & Ho, W. K. O. (2021). From "Decentralization Of Governance" To "Governance Of Decentralization": Reassessing Income Inequality In Periurban China. Environment And Planning A, 53(6), 1473-1489.