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Analysis Of The Effect Of Economic Growth and Capital Expenditures On Regional Financial Independence In Provinces On The Island Of Java

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***Abstract**: Regional autonomy gives regional governments the authority to manage finances independently, including in terms of fiscal decentralization. Over the last decade, Regional Original Income (PAD) in Indonesia has increased by 100%. However, to measure whether this increase is sufficient for regional needs, the Regional Financial Independence Ratio (RKKD) is calculated. This research aims to analyze the influence of economic growth and capital expenditure on regional financial independence in the provinces of Java Island during the 2013–2023 period. The method used is multiple linear regression analysis with panel data from six provinces on the island of Java. The research results show that partially, economic growth has a positive and significant effect on regional financial independence. However, capital expenditure does not have a significant effect. Simultaneously, economic growth and capital expenditure have a significant effect on regional financial independence. These findings indicate that increasing economic growth can strengthen regional fiscal independence, especially through optimizing taxes and levies. However, the effectiveness of capital expenditure still needs to be improved to better support regional independence. The government is expected to focus more on increasing regional revenues through more effective tax collection strategies and more productive allocation of capital expenditure. In addition, fiscal policy should consider differences in economic potential between regions so that the distribution of transfer funds is more targeted.*

***Keywords:** Capital Expenditure,Economic Growth, Regional Independence Level, Regional Original Income*

1. BACKGROUND

Law No. 23 of 2014 concerning Regional Government regulates the regional autonomy system that grants authority, rights, and obligations to regional governments to manage and govern their own affairs. In this system, decentralization takes place to strengthen the government's proximity to the community in providing better services. One of the areas that experiences decentralization is regional finance. Fiscal decentralization is a government instrument to achieve priority development programs, equity, and community welfare across all regions. It aims to reduce disparities between regions and improve regional financial independence in managing their finances (DJPB, 2024).

Fiscal independence becomes an important indicator to assess the ability of regions to manage government and regional financial affairs independently. High fiscal independence indicates that a region is capable of generating adequate local revenue (PAD) to finance development activities and public services without overly relying on transfer funds from the central government (Construction, 2017). Data shows that since the implementation of fiscal decentralization, regional revenues in Indonesia have increased significantly, with a growth

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rate of 321.4% in 2011, signaling the success of improving regional financial independence. Research indicates that fiscal decentralization can enhance public services, streamline resource usage, and strengthen the accountability of regional financial management (Digdowiseiso, 2024).

The importance of fiscal independence lies not only in managing regional resources but also in how regions can maximize their economic potential to create stable sources of income. One way to reduce fiscal gaps between regions is through enhancing the ability of regions to collect taxes and regional levies. This is crucial, given that many regions still rely on transfer funds from the central government as their main funding source (Nuzullestary & Mulyaningsih, 2021). Therefore, independent regional financial management is not only measured by the size of PAD but also by the ability of the region to optimally manage and increase local revenue.

However, the statement that all regions must be financially independent is not always accurate. Each region has different conditions, such as natural resources, human resources, and economic competitiveness. Therefore, some regions may need to receive transfer funds to support development and public services. In this regard, the Regional Financial Independence Ratio (RKKD), as stated in the Minister of Home Affairs Regulation No. 19 of 2020, serves as an essential reference for assessing the level of financial independence of regions. This ratio helps the government determine which regions require transfer funds and the steps needed to improve regional financial management (Sembiring, 2020).

In Java, the majority of regional financial independence is at a medium level, with percentages ranging from 50%-75%. However, there are significant differences between regions' PAD, such as the ratio of PAD between DKI Jakarta and DI Yogyakarta in 2023, which reaches 1:22. This difference is influenced by factors such as people's purchasing power and the cost of living, which are affected by the Provincial Minimum Wage (UMP). Research also shows that rapid economic growth in a region can open up substantial opportunities to increase PAD through taxes and levies, in line with studies stating that fiscal independence can be positively influenced by regional economic growth (Suherman et al., 2023).

Along with increasing regional revenue, regional expenditure must also be considered. Properly allocated regional expenditure can increase capital accumulation and contribute to economic growth. These expenditures should prioritize funding for mandatory government affairs related to basic services to meet Minimum Service Standards (SPM), as stipulated in Minister of Trade Regulation No. 77 of 2020. Effective and efficient expenditures, especially in capital spending, can improve public service infrastructure that directly benefits the community (Todaro & Smith, 2020).

2. LIBRARY STUDY

Regional Autonomy and Fiscal Decentralization

Law no. 32 of 2004 which was subsequently revoked by Law No. 23 of 2014 as a replacement for Law No. 22 of 1999. In Law Number 23 of 2014 concerning Regional Government, regional autonomy is regulated by the statement that regional autonomy is the right, authority and obligation of autonomous regions to regulate and manage government affairs themselves. According to Sudaryo (2017), the delegation of responsibility is followed by fair distribution, utilization and regulation of national resources, as well as balanced central and regional financial management. Regional autonomy is implemented with three main principles, namely: (1) The principle of decentralization, (2) The principle of deconcentration, and (3) The principle of supporting duties. Decentralization will be realized by giving authority to lower levels of government to carry out spending, the authority to collect taxes (*taxing power*), the formation of a council elected by the people, regional heads elected by the people, and assistance in the form of transfers from the central government (Bird & Vaillancourt, 1998). The concept of fiscal decentralization currently used is *money follows function*, in this concept *expenditure assignment* to the regional government simultaneously accompanied by *revenue assignment.* It is hoped that decentralization can increase the efficiency of the public sector and improve local government levels in stimulating economic growth.

Regional Financial Independence (RKKD)

Regional financial independence is the ability of regional governments to finance their own government activities, development and services to the community who have paid taxes and levies as a source of income needed by the region (Halim, 2013). This ratio reflects the level of community participation, where the higher the amount of taxes and levies paid by them, the regional income will increase and community welfare will also increase, resulting in an increase in the RKKD percentage. The Regional Financial Independence Ratio is obtained from dividing Original Regional Income (PAD) by total overall income. PAD is regulated in Law no. 33 of 2004 includes (1) Regional taxes (2) Regional levies, and (3) Income from the management of regional assets which are managed separately. This ratio percentage is able to categorize financial capabilities into four groups, namely: (1) Instructive Relationship Pattern with an independence ratio of 0%-25%, (2) Consultative Relationship Pattern with an independence ratio of 25%-50%, (3) Participative Relationship Pattern with an independence ratio of 50%-75%, and (4) Delegative Relationship Pattern with an independence ratio of 75%-100%.

Capital Expenditure Theory and Economic Growth

According to the Capital Expenditure and Economic Growth Theory by Musgrave (1989), capital expenditure can have a positive impact on economic growth. Economic growth will increase productivity and efficiency in production. Several factors that will influence the relationship between the two are the inflation rate, interest rates and fiscal policy. Musgrave's theory also states that spending on investment can influence economic growth in several ways. Spending in the form of government investment is an investment in long-term assets that can increase regional income and reduce dependence on payments. Thus, the independence of a region can increase economic growth through increased investment in long-term assets and reduced dependence on payments. In addition, regional independence improves the quality of life of the community through increasing access to public facilities, such as roads, schools and hospitals. Thus, regional independence can increase economic growth by improving the quality of life of the community.

Teori Stedwardship

Stewardship theory has roots in psychology and sociology whose design explains a situation where the manager is a steward and acts in the interests of the owner (Davis et al, 1997). Stewardship theory is based on the assumption that organizational success is closely related to owner satisfaction. Stewards (managers) will try to protect and increase the organization's wealth through good company performance, so that owner satisfaction can be maximized. In regional management, regional governments as stewards are given financial trust for the benefit of regional development so that they can be more financially independent. Thus, Stewardship theory can help increase regional financial independence through effective and collaborative management. This can be done by increasing transparency and accountability in regional financial management.

3. RESEARCH METHODS

In this research, descriptive quantitative methods were used to provide an explanation of the cause-and-effect correlation for each numerical variable. According to Sugiyono (2019), the aim of quantitative selection is to collect and correlate data. The following is an attempt to find an answer to whether a variable is capable of causing another variable (Bahri & Zamzam, 2015). This type of secondary data was obtained by collecting documentation from the Regional Income and Expenditure Budget Report (APBD) published by the Website of the Directorate General of Financial Balance (DPJK) of the Ministry of Finance, and Gross

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Regional Domestic Product (PDRB) data from the Central Statistics Agency (BPS). The research sample is panel data consisting of data *time series* 2013-2023 and data *cross-section* 6 provinces on the island of Java. Panel data analysis is used to identify the influence of economic growth and capital expenditure on regional financial independence with the following model estimates:

$$AND_{it} = \alpha + \beta_1 X1_{it} + \beta_2 X2_{it} + \varepsilon_{it}$$

Information:

AND_{it} = Regional KKD ratio of province i in year t (%)

a = Constant

$\beta_1 \beta_2$ = Regression coefficient for each independent variable

$X1_{it}$ = GDP growth rate of province i in year t (%)

$X2_{it}$ = Capital Expenditure of province i in year t (billion rupiah)

ε = Error rate (*error term*)

i = Provincial data

t = Year period (2013,…,2023)

Operational Definition

According to Sugiyono (2019), research variables are everything that researchers choose to study so that data is obtained and conclusions are then drawn.

Table 1. Operational Definition of Variables

Variable	Variable Name	Operational Definition	Measurement Scale	Formula
Dependent Variable	Regional Financial Independence	The ability of local governments to self-fund government activities, including public services and development.	The percentage of original regional income (PAD) compared to total regional revenue in the same period.	Percent (%)
Independent Variable	Economic growth	Numerical index that reflects economic development in a certain period.	GDP growth in a particular year is compared with the previous year and	Percent (%)

			expressed as a percentage.	
	Capital Expenditure	Budget expenditures to acquire fixed assets and other assets that provide benefits for more than one accounting period.	Expenditures include the purchase of land, construction of buildings and structures, acquisition of equipment, expenditure on intangible assets, and other expenses.	Billion Rupiah (Rp)

Source: Data processed by researchers (2024)

4. RESULTS AND DISCUSSION

Results

In table 2, you can see the independence ratio possessed by each province on the island of Java in 2014, 2018 and 2023. In majority, the trend of the regional independence ratio is increasing, there are several regions that experience stagnation in the difference in the independence ratio in one year compared to the previous year. There is only one province that is experiencing a downward trend in the independence ratio, namely Central Java Province in 2023 with a ratio value of 66% from the previous year's 67%, a decrease that is not very significant because it is still included in moderate financial capacity, namely >50-70%. On the other hand, DI Yogyakarta Province in the last decade was still included in the low financial capability group, where Yogyakarta province had a consultative relationship pattern with the central government. Furthermore, Banten Province in the last decade has succeeded in increasing its financial capability, by 2023 Banten only needs to increase its KKD ratio by 1% to move into the high financial capability group. At the same time, DKI Jakarta province in the last decade was still in the medium financial capacity group with the same difference in KKD ratio as Banten Province. Meanwhile, Central Java and East Java are in moderate financial capacity with a participatory relationship pattern. Calculated from the average RKKD of the six provinces on the island of Java, DKI Jakarta Province has the highest figure, namely 69.78 and the lowest figure is occupied by DI Yogyakarta Province with an average RKKD value of 40.32. However, there are interesting facts about the RKKD value in West Java Province, in 2014 West Java had an independence ratio of 67% but this figure is not stagnant because in 2018 it decreased to 58% and in 2023 it experienced a rapid increase to 80% so that it succeeded in entering the high financial capability group with a delegative relationship pattern. The figures obtained in 2023 are the result of the local Bapenda's focus on pursuing revenue targets through outlets and untapped potential, one of which is through the GERMA (Joint Movement) program.

Table 2. Trends in Regional Financial Independence Ratios

Province	Year	PAD	Total Income	RKKD	Train
West Java	2023	22.111,57	27.795,07	80%	Increased
	2018	19.642,91	33.919,02	58%	Increased
	2014	15.038,15	22.310,95	67%	Increased
East Java	2023	22.317,20	33.767,87	66%	Decrease
	2018	18.531,06	31.939,19	58%	Still
	2014	14.442,22	20.772,48	70%	Increased
Central Java	2023	17.071,08	25.391,04	67%	Still
	2018	13.771,84	24.702,32	56%	Increased
	2014	9.916,36	15.157,46	65%	Increased
DKI Jakarta	2023	48.860,01	06.40,9	74%	Increased
	2018	43.327,14	61.235,82	71%	Increased
	2014	31.274,21	43.824,30	71%	Increased
Banten	2023	8.514,35	11.573,49	74%	Increased
	2018	6.329,14	10.320,37	61%	Increased
	2014	4.899,12	7.068,43	69%	Increased
IN Yogyakarta	2023	2.301,32	5.493,06	42%	Increased
	2018	2.040,72	5.443,18	37%	Increased
	2014	1.464,60	3.139,87	47%	Still

Source: Data processed by researchers (2024)

To see whether the Regional Financial Independence Ratio (RKKD) in the six provinces on the island of Java in 2013-2023 was influenced or not by economic growth and capital expenditure, a multiple linear regression analysis was carried out by carrying out descriptive statistical analysis and classical assumption testing first. Table 2 shows that the highest Regional Financial Independence Ratio on Java Island will be in West Java Province in 2023 at 80%. The average RKKD in the research sample was 60%. In terms of economic growth and capital expenditure, the average obtained was 4.61% and 2,938 billion rupiah.

Table 3. Descriptive Statistical Analysis

Variable	**Minimum**	**Maximum**	**Mean**	**Std. Dev**
Regional Financial Independence Ratio (RKKD)	0,33	0,80	0,60	2,40
Economic Growth Rate	-3,39	6,67	4,61	3.224,68
Capital Expenditure	369,39	1.4118,61	2.938,57	0,93

Source: Data processed by researchers (2024)

The selection of the regression model in this study refers to Jude et al (1985) regarding the selection of panel data regression models, if the number of units *time series* (T) size and number of units *cross sectional* (N) is small, then FEM is better to use. This is emphasized in the book Basic Econometrics, where government policy research in basic econometrics uses FEM because it explains unobserved heterogeneity in data, which is common in many economic applications and overcomes endogeneity problems by controlling unobserved factors (Gujarati, 2009). In the context of this research, the dependent variable and independent variables are closely related to government policy, each province has its own policies and ways of running its government. The classical assumption test is carried out to provide certainty that the regression equation used will be consistent and have provisions so that it is not biased. The normality test is carried out using the Jarque-Bera (JB) method with a probability value of 0.320924, where if the probability value of JB is greater than 0.05, it means that the JB statistic is equal to 0 so that H_0 accepted and assumes that the residuals are normally distributed. Next, the multicollinearity test was carried out using the Variance Inflation Factor (VIF) method with a VIF value obtained of 1.035020. These results indicate that the VIF value is smaller than 10, so there is no multicollinearity in the data used. The next stage is the autocorrelation test carried out using the Durbin-Watson method with the d value obtained being 131108 so that it is included in the decision 0 < d < dL which indicates that there is no autocorrelation. This is because the d value obtained is smaller than dL (K = 2 and N = 66), namely 1.5395. Finally, the heteroscedasticity test was carried out using the white method to obtain probability values of 0.0653 and 0.0609, both results were greater than alpha (0.05) so they were free from symptoms of heteroscedasticity.

Table 4. Descriptive Statistical Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Constant	0.571430	0.018469	30.94022	0.0000
Economic Growth Rate	0.010234	0.002949	3.470091	0.0010
Capital Expenditure	-6.24E-06	5.95E-06	-1.049087	0.2985
Dependent variable: Regional Financial Independence Ratio (RKKD)				

Source: Data processed by researchers (2024)

Based on the calculations in table 4, the relationship between the independent variables in the form of economic growth and capital expenditure on the RKKD is formulated using the following equation:

Y = 0.571430 + 0.010234X_1 – 6.24E-06X_2

The constant in the equation in this study is 0.571430. This figure shows that when there are no independent variables, the Regional Financial Independence Ratio (RKKD) will increase by 0.57. If the other independent variables are constant and the rate of economic growth increases by 1%, then the RKKD (Y) will increase by 0.010 with a positive relationship so that the higher the rate of economic growth (X_1) then the RKKD (Y) will be higher. If other independent variables of fixed value increase capital expenditure by 1%, then RKKD (Y) will decrease by 6.24 with a negative relationship so that the higher Capital Expenditure (X_2) then the RKKD (Y) will be lower. The coefficient of determination test results show the value *Adjusted R Square* amounting to 0.768425. This shows that RKKD can be explained by X_1 And X_2 that is the rate of economic growth and capital expenditure was 76.84% (strong relationship), while the remaining 23.16% could be explained by other variables not included in this study. The partial t results show The t-calculated value of economic growth is 3.47, greater than the t-table of 1,99897. This indicates that hypothesis 0 is rejected and it is concluded that partially the rate of economic growth has an effect on the Regional Financial Independence Ratio (RKKD). Meanwhile, the t-calculated value of capital expenditure is -1.05, which is smaller than the t-table 1,99897. This indicates that hypothesis 0 is accepted and it is concluded that partially capital expenditure has no effect on the Regional Financial Independence Ratio (RKKD). Simultaneously, the simultaneous F test produces an f-count value of 31.81, greater than the f-table of 3.143. This concludes that simultaneously economic growth and capital expenditure influence the Regional Financial Independence Ratio (RKKD).

Discussion

From the results of data analysis, it was found that economic growth had a significant positive effect on regional financial independence. This is in line with what the DPR said in 2023 that Increased economic growth will affect the increase in the financial independence ratio, the government must focus on increasing the rate of economic growth so that the independence of the provinces on Java Island improves so that they can dominate the funding of their economic activities independently (DPR, 2023). This means that the decline or increase in the economic rate in the provinces on the island of Java in the last 10 years from year to year has been able to reduce or increase the level of financial dependence of the provincial government on financial assistance from the central government. The higher the number of goods and services produced by a region, the greater the opportunity for income in terms of taxes and levies that the government gets. New revenue channels that will increase local revenue which will have an impact on the RKKD. However, you must pay attention to the types of taxes and levies that have the potential to enter the APBN or APBD. The findings are the same as research conducted by Laoli, et al (2018) which showed that partial economic growth had a significant positive effect on the level of regional financial independence. Regional financial independence appears to have an increasing trend when economic growth increases through development.

Partially, capital expenditure has no significant effect on regional financial independence with a negative coefficient. One of the points that can be indicated from these results is that the capital expenditure budget allocated by the provincial government on the island of Java is not appropriate both in quantity and classification to increase its financial independence capabilities. This can happen because capital expenditures made by the local government are not in accordance with regional needs in providing services to the community in the context of development activities. Several classifications of capital expenditure are considered inappropriate, one of which is capital expenditure for wages and honoraria. Describes how financing for a development is taken from capital expenditures from planning meetings to inauguration. Capital expenditures for wages and honoraria are also found in several areas, such as land teams, technical managers of equipment and machines, technical managers of buildings and structures, and technical managers of roads and bridges. So that the form of capital expenditure results is broader than the benefits that can be felt directly by the government. This finding is supported by research conducted by Andriani (2020) and Maury, et al (2023) that the level of financial independence is not influenced by capital expenditure. In contrast, the Directorate General of Fiscal Balance stated in 2011 that the economic growth of a region is significantly influenced by capital expenditure. Adding infrastructure and facilities in order to increase fixed assets can support economic activities. So in the future, the concept must be deepened *medium/multi-term expenditure framework* (MTEF) which states that capital expenditure must reflect the benefits and financial capabilities of the government in managing long-term assets (Allen and Tommasi, 2001 in Abdullah and Halim, 2006).

CONCLUSION

Based on the results of research conducted on economic growth and capital expenditure which influence regional financial independence at the provincial level on the island of Java in 2013-2023, it was concluded that the average independence ratio in Java province is already at a medium level with a participatory relationship pattern, which means the role of the central government is decreasing considering that the level of independence is close to being able to carry out autonomous affairs. This is significantly influenced by economic growth, but not by capital expenditure. There are also several suggestions that the author puts forward, namely that the government should strive to increase income by expanding and optimizing regional taxes and levies as a source of original regional income, for example, there is a division of 3P taxes (Forestry, Mining and Plantation) between the central government and regional governments.

Apart from that, the government must shift the composition of spending by optimizing capital spending. Optimized allocation of capital expenditure to productive activities is expected to support the sustainability of public infrastructure which will increase public confidence in government performance by reconsidering whether wages and honorarium expenditures are appropriately included in capital expenditure. The increase in the allocation and realization of capital expenditure from the regional expenditure section is carried out in accordance with Law no. 1 of 2022 regarding the minimum portion of public service infrastructure spending of 40%. Finally, the concept of regional independence was re-examined, not only requiring each region in Indonesia to be independent, but becoming a reference material for distributing transfer funds and categorizing regions in relationship patterns according to capabilities. Management of transfer funds by regional governments is expected to be directed at regional development activities with low financial capacity so that they comply with the allocation of transfer funds in the Financial Relations Law between the Central Government and Regional Governments (UU HKPD).

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