

## Financial Performance and Regional Original Income on Provincial Capital Expenditures in Indonesia

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### ABSTRACT

*This study aims to determine the effect of financial performance and local revenue on capital expenditure of provinces in Indonesia. Financial performance is proxied by the degree of fiscal decentralized ratio, dependency ratio, and efficiency ratio. This type of research is quantitative research. The study was conducted in provinces in Indonesia using secondary data in the form of data on the Regional Revenue and Expenditure Budget realization data from 2020 to 2022. The data analysis technique used multiple regression, which was used to test the four hypotheses. The results of this study provide empirical evidence that dependency ratio, efficiency ratio, and local revenue have an effect on capital expenditure, while the degree of fiscal decentralized ratio has no effect on capital expenditure. However, the contribution of the influence of all these independent variables on capital expenditure as the dependent variable is 81.9%, while 18.1% is influenced by other variables not examined in this study.*

**Keywords:** Financial Performance, Local Revenue, Capital Expenditure

### ABSTRAK

Penelitian ini bertujuan untuk mengetahui pengaruh kinerja keuangan dan penerimaan daerah terhadap belanja modal provinsi di Indonesia. Kinerja keuangan diprosikan oleh tingkat rasio fiskal terdesentralisasi, rasio ketergantungan, dan rasio efisiensi. Jenis penelitian ini adalah penelitian kuantitatif. Penelitian dilakukan di provinsi-provinsi di Indonesia dengan menggunakan data sekunder berupa data realisasi Anggaran Pendapatan dan Belanja Daerah dari tahun 2020 hingga 2022. Teknik analisis data menggunakan regresi berganda, yang digunakan untuk menguji keempat hipotesis. Hasil penelitian ini memberikan bukti empiris bahwa rasio ketergantungan, rasio efisiensi, dan pendapatan daerah berpengaruh terhadap belanja modal, sedangkan tingkat rasio desentralisasi fiskal tidak berpengaruh terhadap belanja modal. Namun, kontribusi pengaruh semua variabel independen tersebut terhadap belanja modal sebagai variabel dependen adalah 81,9%, sedangkan 18,1% dipengaruhi oleh variabel lain yang tidak diteliti dalam penelitian ini.

**Kata Kunci:** Kinerja Keuangan, Pendapatan Daerah, Belanja Modal

### INTRODUCTION

Regional autonomy in Indonesia was marked by the passing of Law Number 22 of 1999 which regulates Regional Government. This step was then strengthened by the issuance of Law Number 25 of 1999 concerning Financial Balance between the Central Government and Regional Governments. These two laws ushered in a new era

in the Indonesian government system, especially in terms of managing resources which were previously managed centrally, to a decentralized model. Furthermore, in its development, the Law was updated through the publication of Law Number 32 of 2004 concerning Regional Government. This decentralization policy is related to the emergence of regional autonomy which will be implemented to overcome local regional problems while minimizing the expansion of problems to the center (Suyitno, 2020).

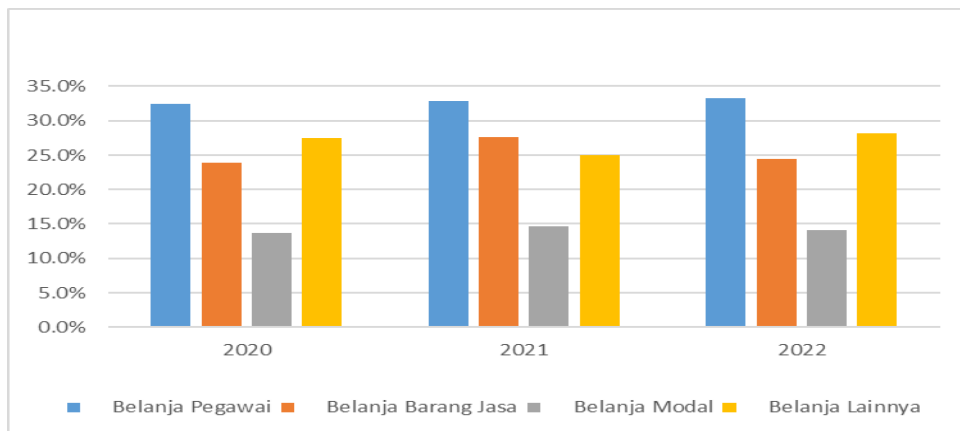
Through fiscal decentralization, it is hoped that regional governments can stimulate the use of local resources and potential to improve the welfare of the population. Based on Article 4 paragraph (2) of Government Regulation Number 58 of 2005 concerning Regional Financial Management, it is regulated that regional financial management is carried out in an integrated system which is realized in the Regional Revenue and Expenditure Budget (APBD) which is determined annually by Regional Regulation.

Regional expenditure based on Minister of Home Affairs Regulation Number 13 of 2006 is all regional obligations that are recognized as a deduction from the value of net assets in the relevant fiscal year period. Regional expenditure refers to all expenditure originating from the Regional General Cash Account and reduces cash equity in one budget year, which is a regional obligation. This expenditure is used to carry out government tasks that are under the authority of the province or district/city, including tasks regulated in statutory regulations, which consist of mandatory and optional matters.

One component of regional spending is capital expenditure. Based on Government Regulation Number 71 of 2010, capital expenditure is regional government expenditure whose benefits exceed one budget year and will increase regional assets or wealth and will further increase routine expenditure such as maintenance costs in the general administration expenditure group.

Indonesia, as one of the largest countries in the world which as of October 2022 has 34 provinces, certainly has a unique policy in managing regional finances in accordance with the regulations stated in the law, especially in terms of allocating capital expenditure funds. Therefore, the accurate and targeted allocation of capital expenditure funds will play an important role in improving people's welfare through increasing economic productivity in Indonesia. Increasing economic productivity can be done by increasing capital expenditure, such as building public service infrastructure and infrastructure that focuses on improving the economy (Pane et al., 2021).

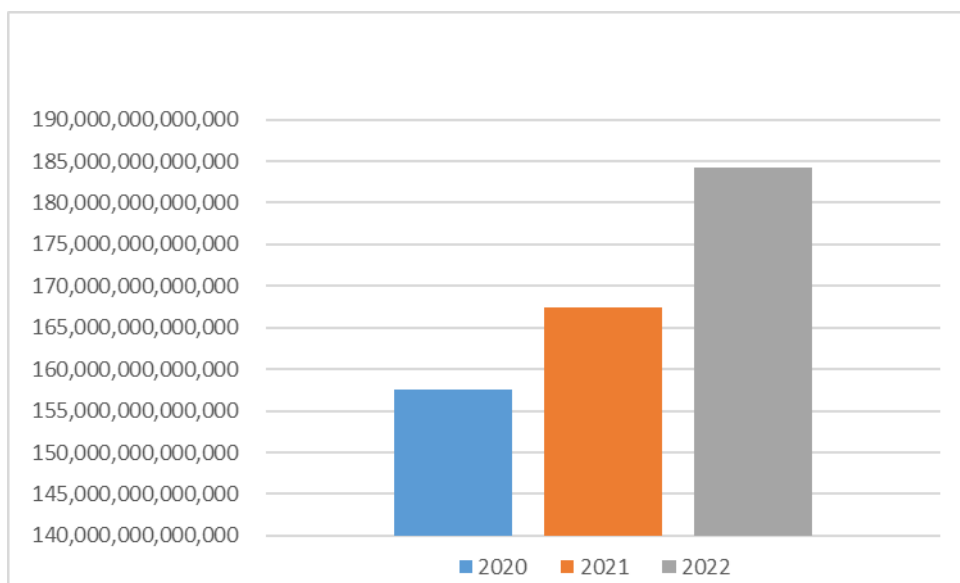
**Figure 1. Provincial regional spending trends in Indonesia in 2020-2022**



Source djpk.kemenkeu.go.id, 2023

Figure 1 above shows the trend in the composition of provincial regional expenditure in Indonesia from 2020-2022. It can be seen that personnel spending dominates from year to year with an average proportion of more than 32% in that period. Meanwhile, capital expenditure based on the figure above has a smaller proportion compared to employee expenditure. Provincial capital expenditure in Indonesia averages 14.12% of total regional expenditure, from 2020 to 2022. This data shows that the budget for capital expenditure has not been a top priority in the implementation of provincial APBDs in Indonesia. So that provincial governments in Indonesia have limitations in development activities, with minimal capital expenditure.

**Figure 2. Provincial Capital Expenditures in Indonesia 2020-2022**



Source djpk.kemenkeu.go.id, 2023

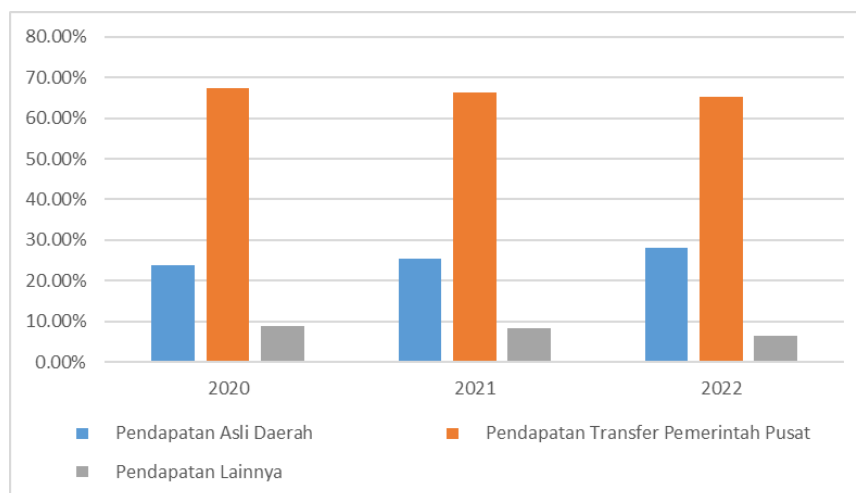
The use of financial ratios as a tool for analyzing financial performance has been widely applied to commercial corporate institutions, while in public institutions, especially local governments, it is still very limited, so that theoretically there is no unanimous agreement regarding the name and measurement rules (Priyono et al., 2020)..Based on previous research, there is an influence between regional financial performance and capital expenditure allocation. Whether regional financial performance is good or not can be seen by conducting financial ratio analysis (Indiyati & Rahyuda, 2018).

Based on previous research, regional financial performance indicators can be proxied by the ratio of the degree of fiscal decentralization, dependency ratio, and regional financial efficiency ratio. Suyitno (2020) examined the influence of regional financial performance on capital expenditure allocation using proxies for the fiscal decentralization ratio, financial independence ratio, PAD effectiveness ratio, financial efficiency ratio and SiLPA financing level ratio. Other research by Arif & Arsa (2018) uses proxies for regional financial independence, PAD effectiveness, regional financial efficiency and spending harmony.

One of the components in the APBD is regional income. Based on Law Number 23 of 2014 concerning regional government, Article 285 states that regional income sources consist of Original Regional Income, transfer income, and other legitimate regional income. Original Regional Income includes regional taxes, regional levies, results from the management of separated regional assets and other legitimate regional original income.

Regional Original Income (PAD) is one source of regional income obtained by regional governments through collections based on regional regulations in accordance with statutory regulations. The aim of PAD is to give regional governments the authority to fund the implementation of regional autonomy in accordance with the potential of the region, in line with the principle of decentralization. One of the most dominant components in PAD is local taxes.

**Figure 3. Provincial Regional Income in Indonesia 2020-2022**



Source djpk.kemenkeu.go.id, 2023

In the last three years, provinces in Indonesia contributed an average of 25.74% of total regional income, lower than transfer income from the Central Government. In nominal terms, the value of PAD has increased from IDR 32.943 trillion in 2020 to IDR 297.009 trillion in 2021. And it has increased from IDR 24.645 trillion in 2021 to IDR 321.655 trillion in 2022. This data shows that the role of provincial PAD in Indonesia is quite strategic. in supporting the decentralization program mandated by law in order to finance government programs by reducing financial dependence on the central government. With an increase in Original Regional Income (PAD), regional governments have more flexibility in allocating regional budgets, including in terms of capital expenditure.

## RESEARCH METHODS

Descriptive research was carried out using correlation techniques (correlational descriptive). This technique is carried out to analyze the relationship between four independent variables, namely the degree of decentralization ratio (X1), dependency ratio (X2), efficiency ratio (X3), and Regional Original Income (X4) to capital expenditure (Y).

The population of this research is all provinces in Indonesia, consisting of 34 provinces. Researchers make the entire population

The time series data used in this research are from 2020 to 2022. The data for 2020-2022 was selected taking into account the fluctuating development of capital expenditure and post-Covid 19 pandemic conditions. Meanwhile, the cross section data used in this research is 34 provinces in Indonesia.

The data used in this research is secondary data obtained from the annual report of the Directorate General of Financial Balance (DJPk). This data is in the form of provincial Budget Realization Report data in Indonesia which can be accessed via the website <http://www.djpk.kemenkeu.go.id/>.

The data in this research was then processed using multiple linear regression analysis tools with the research model used in this research being as follows:

$$Y = a + b_1 X_1 + b_2 X_2 + b_3 X_3 + b_4 X_4$$

Information:

Y = Capital Expenditures

a = Constant

X1 = Ratio of the degree of fiscal decentralization

X2 = Dependency ratio

X3 = Efficiency ratio

X4 = Regional Original Income

## RESULTS AND DISCUSSION

### 1. Multiple Linear Regression

**Table 1. Results of Multiple Linear Regression Analysis**

Variable	Unstandardized Coefficients B
(Constant)	30,112,686,133,233,133
Decentralization degree ratio (X1)	-41,433,029,601,265,090
Dependency ratio (X2)	25,362,430,661,278,650
Efficiency ratio (X3)	1,486,414,141,023,120
PAD (X4)	0.353

Source: Regression Analysis Results, Appendix 8

From table 1, the following regression equation model can be obtained:

$$Y = 30,112,686,133,233.133 - 41,433,029,601,265,090X1 + 25,362,430,661,278,650X2 + 1,486,414,141,023,120$$

The regression model equations can be explained respectively as follows:

- 1) The constant (absolute) value is 30,112,686,133,233.133, which means that the independent variables, the ratio of the degree of fiscal decentralization, dependency ratio, efficiency ratio, and PAD are considered constant, equal to 0, so the value of capital expenditure is 30,112,686,133,233.133, assuming the other variables remain constant.
- 2) The ratio value of the degree of fiscal decentralization is equal to -41,433,029,601,265,090, then every time the decentralization degree ratio is increased by 1 unit, the value of capital expenditure will also increase by -41,433,029,601,265,090 assuming other variables remain constant.
- 3) The dependency ratio value is equal to 25,362,430,661,278,650. So every time the dependency ratio is increased by 1 unit, the value of capital expenditure will also increase by 25,362,430,661,278,650 assuming other variables remain constant.
- 4) The efficiency ratio value is equal to 1,486,414,141,023,120. So every time the dependency ratio is increased by 1 unit, the value of capital expenditure will also increase by 1,486,414,141,023,120 assuming other variables remain constant.
- 5) The PAD value is 0.353, so every time PAD is increased by 1 unit, the value of capital expenditure will also increase by 0.353 assuming other variables remain constant.

### Test Model Feasibility (F Test)

**Table 2. Table of F Test Results**

Information	Fcount	Ftable	Sig. count	Sig.	Results
F test	110,009	2.49	0,000	0.05	Decent model

Source: Regression Analysis Results, Appendix 8

Based on the table above, it shows that the  $t_{count}$  value is 110.009. The  $t_{count}$  results were consulted with  $t_{table}$  with a significance level of 5% (0.05). This shows that  $t_{count} > t_{table}$  ( $110.009 > 2.49$ ) and the significance level of the Sig. equal to  $0.000 < 0.05$  is smaller than 0.05. So it can be concluded that  $H_0$  is rejected and  $H_a$  is accepted, meaning that there is a significant influence between the variables of the degree of decentralization ratio, dependency ratio, efficiency ratio, and PAD simultaneously on capital expenditure in provinces in Indonesia. These results are in line with research by Sutjipto et al. (2019) who found that the ratio of the degree of fiscal autonomy, regional financial dependence simultaneously influences regional spending. Research by Marlina et al. (2017) also provide the same results: the degree of decentralization, regional dependence, financial independence, and effectiveness of PAD together influence the allocation of capital expenditure.

## Hypothesis Test (t Test)

Table 3. T Test Results

Hypothesis	tcount	ttable	Sig.	Standard	Information
H1	-0.140	< 1,984	0.074	> 0.05	No effect
H2	4,055	> 1,984	0,000	< 0.05	Influential
H3	2,675	> 1,984	0.009	< 0.05	Influential
H4	18,016	> 1,984	0,000	< 0.05	Influential

Source: Regression Analysis Results, Appendix 8

### 1) The Effect of the Degree of Decentralization Ratio on Capital Expenditures

Hypothesis 1 proposed in this research is that the ratio of the degree of fiscal decentralization has an effect on capital expenditure. Based on the table above, a  $t_{count}$  value of 0.140 can be obtained. This shows that the  $t_{count}$  value  $< t_{table}$  1.984 and the significance value is  $0.074 > 0.05$ , so it can be concluded that  $H_0$  is accepted and  $H_a$  is rejected. It can be concluded that the partial degree of decentralization ratio does not have a significant influence on capital expenditure.

### 2) The Effect of Dependency Ratio on Capital Expenditures

Hypothesis 2 proposed in this research is that the dependency ratio has an effect on capital expenditure. Based on the table above, a  $t_{count}$  value of 4.055 can be obtained. This shows that the  $t_{count} > t_{table}$  1.984 and the significance value is  $0.000 < 0.05$ , so it can be concluded that  $H_0$  is rejected and  $H_a$  is accepted. It can be concluded that the partial dependency ratio has a significant influence on capital expenditure.

### 3) The Effect of Efficiency Ratios on Capital Expenditures

Hypothesis 3 proposed in this research is that the effectiveness ratio influences capital expenditure. Based on the table above, a  $t_{count}$  value of 2.675 can be obtained. This shows that the  $t_{count} > t_{table}$  1.984 and the significance value is  $0.009 < 0.05$ , so it can be concluded that  $H_0$  is rejected and  $H_a$  is accepted. It can be concluded that the partial efficiency ratio has a significant influence on capital expenditure.

#### 4) Influence of PAD on Capital Expenditures

Hypothesis 4 proposed in this research is that PAD influences capital expenditure. Based on the table above, a t-count value of 18.016 can be obtained. This shows that the tcount > ttable 1.984 and the significance value is  $0.000 < 0.05$ , so it can be concluded that  $H_0$  is rejected and  $H_a$  is accepted. This can be concluded that partial PAD has a significant influence on capital expenditure.

#### Coefficient of Determination Test

**Table 4. R2 Test Results**

Model	Adjusted R Square	Information
1	0.819	Influence of 81.9%

Source: Regression Analysis Results, Appendix 8

Based on table 4, the R2 (R Square) figure is 0.819 or (81.9%). This shows that the percentage contribution of the influence of the independent variable (decentralization degree ratio, dependency ratio, efficiency ratio, and PAD) on the dependent variable (capital expenditure) of 81.9%. Or variations of the independent variables used in the model (decentralization degree ratio, dependency ratio, efficiency ratio, and PAD) was able to explain 81.9% of the variation in the dependent variable provincial capital expenditure in Indonesia. Meanwhile, the remaining 18.1% is influenced or explained by other variables not included in this research model.

#### Discussion

##### 1. The ratio of the degree of fiscal decentralization has a significant effect on capital expenditure

Based on the test results as presented in table 4.10, it shows that the degree of decentralization ratio does not have a significant effect on capital expenditure. The degree of decentralization ratio describes the contribution of PAD to total regional income. If we look at the decentralization degree ratio value data, it can be seen that the average provincial PAD in Indonesia only contributes around 20.79% of the total realization of regional income for each province.

Research by Kristianto et al. (2023), Khafif and Romandhon (2022) show the same results that the ratio of the degree of decentralization has no influence on the allocation of capital expenditure. Research with different results includes Purnamawati (2019) and Indiyanti & Rahyuda (2018) which states that the partial decentralization degree ratio does not have a significant positive effect on capital expenditure.

##### 2. The dependency ratio has a significant effect on capital expenditure

Based on the test results as presented in table 4.10, it shows that the dependency ratio has a significant effect on capital expenditure. The dependency ratio shows how much local government is dependent on transfer funds from the central government in budget implementation.

Based on the data obtained, the average dependency ratio for provinces in Indonesia is 72.24%, which shows that these regions are still very dependent on transfer funds from the central government. Research Ilugbusi et al. (2021) in the states of Southwest Nigeria show the same results that the dependency ratio has an influence on the allocation of capital expenditure.

### 3. **The efficiency ratio has a significant effect on capital expenditure**

Based on the test results as presented in table 4.10, it shows that the efficiency ratio has a significant effect on capital expenditure. Research by Kristianto et al. (2023), Suryantini et al. (2018), Indiyanti & Rahyuda (2018), Suyitno (2020) also support the results of this research. The research results show that the efficiency ratio has a significant effect on capital expenditure.

The efficiency ratio is a comparison between total expenditure realization and total income realization in a certain period. Regional governments must be selective in spending so that they are right on target and can increase the capital expenditure budget which can stimulate economic growth in each region.

### 4. **PAD has a significant effect on capital expenditure**

Based on the test results as presented in table 4.10, it shows that PAD has a significant effect on capital expenditure. The greater the realization of PAD will increase capital expenditure, thus expanding the space for local governments to allocate capital expenditure. Research by Kristianto et al. (2023), Pane et al. (2021), Huda & Sumiati (2019), Rohmah & Riharjo (2019) and Lestari & Utama (2019) provide results that support the results of research conducted, that PAD has an effect on capital expenditure. With the increasing realization of PAD, regional governments have optimized the revenue potential in their respective regions. Several steps that regional governments can take to increase Original Regional Income include intensification and extensification of Regional Taxpayers. Intensification involves optimizing tax revenues from registered Regional Taxpayers, while extensification involves adding Regional Taxpayers or new regional tax objects.

## **CONCLUSIONS AND RECOMMENDATIONS**

In general, the results of this research inform that the degree of fiscal decentralization ratio, dependency ratio, efficiency ratio, PAD together influence capital expenditure. The contribution of influence was 81.9%, while 18.1% was influenced by other variables not examined in this research. Meanwhile, partially the research results are as follows: The ratio of the degree of fiscal decentralization has no effect on capital expenditure. This is due to the contribution of PAD which is relatively low when compared to total regional income. Regions are still very dependent on transfer funds from the central government regarding spending in APBD components. The dependency ratio has a significant positive effect on capital expenditure. The efficiency ratio has a significant positive effect on capital expenditure. PAD has a significant positive effect on capital expenditure.

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