

THE EFFECT OF REGIONAL FINANCIAL PERFORMANCE ON REGIONAL FINANCIAL INDEPENDENCE IN THE PROVINCE OF CENTRAL JAVA

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Abstract

This research was conducted to determine how a city or district area can be independent in financing all government operational activities without depending on the central government. This study aims to determine the factors that affect regional independence. This research is also used for evaluation in government financial management and decision-making for stakeholders in investing by seeing whether the area is independent or not. The research uses quantitative method based on secondary data, including data from the Central Statistics Agency (BPS) of Central Java Province in 2019, stating the number of districts as 29 and cities as many as 6 cities in Central Java. The sample selection used in this study used a purposive sampling technique where the data used in this study contained data from the 2015-2019 Regional Government Financial Reports. Data analysis uses panel data regression with data application processing, namely EvIEWS 10. The results of this study reveal several variables that affect regional financial independence; namely, efficiency ratios that have a positive effect on regional independence, capital expenditure compatibility ratios that have a positive impact on regional financial independence, and effectiveness ratios that have a positive effect on the level of regional financial independence. Meanwhile, the variable that does not affect the level of regional independence is operating expenditure.

Keywords: Capital Expenditure, Effectiveness, Operating Expenditure, Regional Financial Independence

1. INTRODUCTION

A region's self-government is an authority with the right and obligation to self-regulate all government affairs for the benefit of the community and comply with the laws and regulations (Imawan & Wahyudin, 2014). According to the Decree of the People's Consultative Assembly (hereinafter referred to as MPR) of the Republic of Indonesia No. XV/MPR/1998 concerning the Implementation of Regional Government, the Regional Government, has several policies, namely improving public services and developing community creativity, equity, and finance in the central relationship between the government and the regions. Hence, government need to create more comprehensive regional independence (Mahsun, 2006; Periansya, 2019). The achievement of regional funding expenditures is part of the manifestation of the specificity of the area intending to improve people's living standards (Oktalina, 2020). The declaration is contained in the guideline of regulation No. 32 of 2004 concerning Regional Government, by giving opportunities to the area to reach the regional treasury in solitude.

The area's autonomy is arguably a good opportunity for the government to show all its capabilities in completing regional tasks (Susanto & Rahayu, 2021; Tolosang, 2018). Regional fiscal independence, especially in Central Java, has many factors, namely economic growth, efficiency, effectiveness, harmony, and the last is local revenue (Anynda & Hermanto, 2020). As a result, this situation is related to the performance of local government taxes, which will increase people's income, and the increase in revenue will have an effect in terms of paying taxes consciously so that the total regional income will increase significantly (Ermawati & Aswar, 2020; Febriyanti & Faris, 2019). Higher regional income in certain regions results in better provincial fiscal freedom during the period (Andriani & Wahid, 2018; Tolosang, 2018; Wira & Suyana, 2019).

The main characteristic of regions that can implement regional autonomy is the ability of provincial finances to manage their finances and finance government activities. Local governments rely heavily on transfers from the central government to carry out various activities organized by the state (Halim, 2007). This case shows the weakness of PAD which has not been able to cover regional spending, especially the most prominent capital expenditure (Hariani & Febriyastuti, 2020; Malau & Parapat, 2020). The local government incurs inadequate repercussions for regional autonomy when compared to the cost of employees and the cost of paying an object to keep the area expenditure secret (Malau & Parapat, 2020). The Central Java provincial government's level of financial independence is still somewhat participatory, as contained in the Central Java Antara news 2019 (Antaranews.com, 2019a). Since the implementation of Fiscal Decentralization, local governments are required to manage everything independently, including managing regional finances. The existence of fiscal decentralization is nothing but to provide developments for regional independence and independence especially (Renyaan et al., 2012). With regional autonomy, it is expected that services from local governments to the community will be better. In addition, higher regional independence will also improve the community's welfare (Kaunang, 2016).

However, funding from the central government remains as financial assistance to the regions from the center to develop their areas. The dependence of local governments on the central government is a severe problem because it means that local governments have not been able to manage their local revenues effectively and efficiently. Local governments also experience the pain of staying connected between regions and the center of Central Java. Where Central Java only has a fiscal decentralization value of 42.08 percent and Original Local Government Revenue (hereinafter referred to as PAD) contribution of 55.10 percent (Antaranews.com, 2019b). With the contribution value of PAD at 55.10 percent, Central Java is included in the Participatory category. From these issue, it is hoped that the Central Java government needs to fight even harder so that there is an increase in the PAD received (Antaranews.com, 2019a). Several research questions in this study are whether the efficiency ratio affects regional financial independence, whether the effectiveness ratio affects regional financial autonomy and whether the compatibility ratio variable affects non-central income. Not only in the field of study questions in this study, but there is also a research contribution to regional and central government because of how important it is to improve regional financial performance and often evaluate government financial management to increase regional financial independence. For stakeholders, it is used to determine whether the area is independent. Hence, it is easy for stakeholders to make decisions to invest

2. LITERATURE REVIEW

2.1. Signaling Theory

This theory is used to point in an excellent direction to many essential parts to stakeholders with a lack of notification and positive signals. Signal theory, if in the public sector, is used by the government to provide a good sign for great economic reports where the impact can be experienced by the community with central government facilities by the government (Yuliyanti et al., 2019). In conclusion, the non-central economy is significant for transparency to the broader people because it is intended to show the expertise possessed by the government in the management and availability of regional resources. According to Malau & Parapat (2020), the relationship with this theory is that local governments facilitate directions in the form of notification of regional results efficiently, competently, and maximally for the welfare of the people in the region.

2.2. Regional Financial Independence

This theory describes the regional level of dependence on external funding sources. If the independence ratio is high, local governments are less dependent on external assistance and vice versa. It directs this non-central expertise to self-financing all government implementation and development to facilitate the people (Febriyanti & Faris, 2019). According to Halim (2007), this shows the regional economy at the average value of PAD compared to PAD from other sources, such as government loans or central assistance. With the addition of regional freedom, the external linkages of local governments, especially top and provincial governments, are reduced (Hariani & Febriyastuti, 2020; Imawan & Wahyudin, 2014; Nasution, 2019).

Table 1. Criteria for Regional Funding Independence Ratio

Funding Independence Ratio	Criteria
00.00% - 25.00%	Very low
25.01% - 50.00%	Low
50.01% - 75.00%	Moderate
75.01% - 100.00%	High

Source: Mardiasmo (2016)

The measure of freedom reflects the number of people paying off regional bills, which are an essential part of PAD. The higher regional bills and the distribution paid by the community, the clearer the picture of the higher level of the community will benefit. This is the most crucial component of local revenue.

2.3. Financial Performance

According to Mardiasmo (2016), local government financial performance measurement can be done from three aspects: improving local government performance, assisting in resource allocation, and decision making. Ultimately, local governments need to achieve public accountability and improve institutional communication. The progress of non-central finance can also assess the government's performance in providing a good form of public service to the community (Saputra, 2014).

2.4. Efficiency Ratio

The Efficiency Ratio is the maximum output size with reduced use of resources and facilities. Further, Mardiasmo (2016) highlight that the ability of local governments to rationalize local government costs. The lower the efficiency, the better the government's performance (Mardiasmo, 2016). Regional budget efficiency is the extent to which local governments carry out an activity or service, measured by comparing expenditure realization with revenue realization (Nasution, 2019). With a low level of efficiency, it is hoped that local governments are said to be able to manage their finances efficiently. Therefore, the success of independent financial management will reduce the value of the dependence of local governments on the central government. Hence, the smaller the efficiency ratio will increase the value of the regional financial independence ratio (Anynda & Hermanto, 2020; Hariani & Febriyastuti, 2020; Nasution, 2019). The efficiency ratio is said to be low because this study looks at how to measure it from the ratio (Agustina et al., 2012); spending is more remarkable than income. It can be said that there are several inconsistent studies, so in regional expenditure, there are two sub-sections, the first is operating expenditure and the second is capital expenditure. Many studies say that local governments still focus on their operational expenses, not on their capital expenditures, which should be where local governments must increase the value of their capital expenditures.

H1 Efficiency Ratio has a positive effect on Regional Financial Independence.

2.5. Financial Efficient Measure

Financial Efficient Measure is a symbiosis where efficient expenditure and income measure the achievement of results in a program with a predetermined target. The effectiveness ratio can describe the ability of the local government to realize the planned revenue and then compare it with the target that has been approved based on the regional advantages (Halim, 2007). Therefore, it can be concluded that the higher the effectiveness ratio, it can be proven the local government's ability is getting better. Through this effectiveness ratio, the success of local governments in carrying out their regional finances can be measured effectively (Anynda & Hermanto, 2020). With success in increasing this effectiveness, hence it will reduce the interference of the central government in the performance of the regional government; therefore, the higher the value of the effectiveness ratio will increase the value of the regional financial independence ratio itself (Anynda & Hermanto, 2020; Kaunang, 2016; Oktalina, 2020; Saputra, 2014).

H2 Efficient Measure of positive attachment to funding freedom Area

2.6. Compatibility Size

The compatibility relationship can describe how local governments prioritize routine allocations of funds for daily expenditures and regional development (Imawan & Wahyudin, 2014). The higher the proportion of funds intended for regular government spending, the lower the balance of funds used to provide economic infrastructure for the community (Halim, 2007).

- 1) Ratio of operational costs, namely total operating costs compared to total area costs.
- 2) The level of investment is the comparison between the total realization of the investment budget and the total expenditure in an area.

The OpEx Compatibility Ratio describes how the government allocates funds to the best priority for public service spending, measured by comparing total operating costs with complete regional expenditure results. Namely, by prioritizing provincial government spending on operational expenditures, it is hoped that concerns for the people will be fully maximized to improve the community's welfare. Increasing the interest of the community will undoubtedly impact the regional economy so that the level of regional independence will also increase. H3a The Harmony Ratio (Operational Expenditure) gives a good value because it does not depend on the center's provincial finances.

The construction of regional fittings was taken from the initial shopping area, shopping areas, and roads (Halim, 2007). Providing a budget for improving public facilities will facilitate the mobility of goods/services listed in the rules of accounting standards. The increase in the mobility of goods/services will undoubtedly have an impact on increasing the economy in the region (Hendawati et al., 2018). When the economy in the areas has grown, it can be interpreted that the ability of local governments to run their government independently has been successful; therefore, a high capital expenditure ratio will also increase regional financial independence (Andriana, 2020; Ermawati & Aswar, 2020; Handayani & Erinos, 2020; Hariani & Febriyastuti, 2020; Hendawati et al., 2018; Malau & Parapat, 2020). Meanwhile, no previous research has examined the relationship between the compatibility ratio and regional financial independence. This contribution is still related to the efficiency ratio, where many local governments focus on operating expenditures instead of capital expenditures. The provincial government should increase capital expenditures so that the efficiency ratio is good. This compatibility ratio is used to consider and determine how the efficiency ratio affects regional financial independence.

H3b Harmony Ratio (Capital Expenditure) Positively Affects Regional Financial Independence.

3. RESEARCH METHODS

3.1. Data Types and Sources

The type of processing used is secondary data. Secondary data in this study include financial data and information from the Central Statistics Agency (hereinafter referred to as BPS), the Supreme Audit Agency (hereinafter referred to as BPK), materials, basic books, journals, and newspapers related to this study. Based on secondary data from Central Statistics Agency (BPS), data is used to study the economic growth of the Central Java regions/municipalities and then obtain data from the Supreme Audit Agency (BPK). It is to know the regional financial performance and the percentage of raw revenue from Local Government Financial Reporting (hereinafter referred to as LKPD) and determine the level of regional financial independence.

3.2. Sample and Population

The use of population in this study is all districts and cities in the province of Central Java. According to the BPS (Central Statistics Agency), in 2019, the number of communities was 29, and six cities were in Central Java. The sample selection used in this study uses a purposive sampling technique. The data for this study includes data from the Regional Government Financial Statements obtained from the BPK for the 2015-2019 period in Central Java Province.

3.3. Collecting Data Method

This study method is used to classify materials according to needs using several types of data collection, namely library research. In library research, the writer obtains and collects data by reading and researching academic books and notes related to research. Internet Research The author receives research-related data through the website.

3.3.1. Factor Measurement

Usage factors in the study are also interpreted according to the definition and how each variable is measured:

Table 2. Variable Measurement

Variable	Formula	Description
Efficiency Ratio	$\frac{\text{Actual Total Expenditure}}{\text{Realized Total Revenue}} \times 100\%$	
Effectivity Ratio	$\frac{\text{Realization of PAD}}{\text{PAD budget}} \times 100\%$	PAD = Locally-Generated Revenue
Compatibility ratio (Operation Spend)	$\frac{\text{Operating expenditure realization}}{\text{Total expenditure realization}} \times 100\%$	
Compatibility Ratio (Capital Expenditure)	$\frac{\text{Capital expenditure realization}}{\text{Total expenditure realization}} \times 100\%$	
Regional Financial Independence Ratio	$\frac{\text{Realization of PAD}}{\text{Total PD realization}} \times 100\%$	PAD = Locally-Generated Revenue PD = Locally-Generated Revenue
Areas Size	Ln (Total Assets)	

3.1.2. Analysis Model

By using the EvIEWS data analysis method, the formula is as follows:

$$KKD_{it} = \alpha + \beta_1 Ref_{it} + \beta_2 Re_{it} + \beta_3 Rso_{it} + \beta_4 Rsm_{it} + \varepsilon_{it}$$

Information:

KKD : Regional Financial Independence

α : Constant

β : Coefficient of linear regression

Ref : Efficiency Ratio

Rek : Effectiveness Ratio

Rso : Operating Compatibility Ratio

Rsm : Capital Match Ratio

ε : error term (interference error rate)

N : Number of Observations

it : Amount of Time

The analysis used in this study uses an estimation test consisting of a combined effect model, a fixed effect model, and a random effect model. The model was determined using the Chow and Hausman test, followed by the normality test. Classical acceptance test includes multicollinearity, and heteroscedasticity test, autocorrelation test, and hypothesis test include t test, F test, and R² test.

Table 3. List of Regencies and Cities of Central Java Province

No	Areas
1	Banjarnegara Regency
2	Banyumas Regency
3	Batang Regency
4	Blora Regency
5	Boyolali Regency
6	Brebes Regency
7	Cilacap Regency
8	Demak Regency
9	Grobogan Regency
10	Jepara Regency
11	Karanganyar Regency
12	Kebumen Regency
13	Kendal Regency
14	Klaten Regency
15	Kudus Regency
16	Magelang Regency
17	Pati Regency
18	Pekalongan Regency
19	Pemalang Regency
20	Purbalinga Regency
21	Purworejo Regency
22	Rembang Regency
23	Semarang Regency
24	Sragen Regency
25	Sukoharjo Regency
26	Tegal Regency
27	Temanggung Regency
28	Wonogiri Regency
29	Wonosobo Regency
30	Magelang City

Source: (BPS, 2020)

4. RESULTS AND DISCUSSION

Table 4 below shows that the ratio of non-central independence has a value in size (mean) of 22.82%. It can be interpreted that districts and cities in Central Java during the 2015-2019 period have financing expertise and implementation of government events which are still very low or still in the Instructive category. In this ratio of regional independence, there are 175 data, with the ability of the local government to be categorized as Instructor (very poor) as much as 134 data, Low (Consultative) with 35

data, Medium (Participatory) with 3 data, and high category (Delegative). as many as 3 data. In addition, the lowest (minimum) regional independence ratio value was 10.16% in Klaten Regency in 2015. Meanwhile, the highest regional independence ratio value of 86.61% was obtained by Semarang City in 2019. The Effectiveness Ratio of the overall data obtained on average (mean) is 107.16%, which means districts and cities in Central Java can realize local revenues according to the 2015-2019 plan or are targeted so that they are included in the practical category. The effectiveness ratio data can be grouped into the category of ineffective local government in as many as 29 data. The provincial government that is included in the balanced, effective category is 9 data, and for local government, that is in the practical category as much as 137 data. The most minor (minimum) data on the effectiveness ratio of 83.66% was obtained by Pekalongan Regency in 2019, while Batang Regency received the most prominent (maximum) data of 138.78% in 2019.

Table 4. Descriptive Statistics

	Y	X1	X2	X31	X32
Mean	22.82526	107.1608	88.81343	20.34280	78.83000
Median	19.46000	107.5400	86.60000	19.97000	79.03000
Maximum	86.61000	138.7800	114.9800	36.03000	95.61000
Minimum	10.16000	83.66000	71.31000	4.950000	63.93000
Std. Dev.	11.76941	8.035842	9.031236	4.807471	5.352588
Observ	175	175	175	175	175

The Effectiveness Ratio from the overall data obtained on average (mean) is 107.16%; namely, districts and cities in Central Java can achieve revenue for all regions according to the plan or target starting from 2015 to 2019. So it is included in the practical category. The effectiveness ratio data can be grouped into the category of ineffective local government in as many as 29 data. The provincial government that is included in the balanced, effective category is 9 data, and for local government, that is in the practical category as much as 137 data. The most negligible (minimum) data on the effectiveness ratio of 83.66% was obtained by Pekalongan Regency in 2019, while Batang Regency obtained the most significant (maximum) data of 138.78%.

Based on the data in Table 4 (Descriptive Statistics), it can be seen that the average value (mean) of the efficiency ratio is 88.81%. This means that districts and cities in Central Java province for the 2015-2019 period have expertise in realizing regional expenditures and regional incomes are already efficient. In this efficiency ratio, 21 data fall into the inefficient category (above 100%), then 8 data fall into the balanced efficiency category (100%), and 146 data in the efficient type (below 100%). The lowest (minimum) efficiency ratio value of 71.31% was obtained by Klaten Regency in 2019, while Brebes Regency received the highest (maximum) efficiency ratio value of 114.98% in 2018

Based on this data, the mean value for capital expenditure is 20.34%, so local governments' priority in allocating the budget for capital expenditure tends to be low. The lowest (minimum) capital expenditure ratio value of 4.95% was obtained by the Rembang

Regency in 2015, while the Demak Regency received the highest (maximum) capital expenditure ratio value of 36.03% in 2016. From the overall data obtained, the average value (mean) of the operational expenditure ratio is 78.83%, so the priority of the regional government in allocating the budget for its operational expenditure tends to be high. The lowest functional expenditure ratio value (Minimum) of 63.93% was obtained in Demak Regency in 2016, while Kendal Regency received the highest (maximum) operational expenditure ratio value of 95.61% in 2019.

4.1. Coefficient of Determination (R^2)

The regression test is to explain the results of R^2 can refer to the R-squared worth 0.941615 or 94.2%. It can be grouped from 2015 to 2019; the independent variables are the Efficiency Ratio, Utility Ratio, and Compatibility Ratio of Capital Expenditure to OpEx at the provincial and local government levels in Central Java. The regional control variable for fiscal independence is 94.2% which can be explained. Meanwhile, 5.8% is explained by different factors from other studies.

Table 5. Hypothesis Experiment Using Simultaneous Experiment (F)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
X1	-0.053945	0.025301	-2.132149	0.0352
X2	-0.113165	0.030370	-3.726189	0.0003
X31	0.234685	0.089929	2.609668	0.0103
X32	0.050087	0.083208	0.601950	0.5484
C	27.99263	9.532403	2.936576	0.0040
Effect Specifications				
Cross-section fixed (dummy variables)				
R-squared	0.956406	Mean dependent var	20.91623	
Adjusted R-squared	0.941615	S.D. dependent var	8.046118	
S.E. of regression	1.944179	Akaike info criterion	4.385332	
Sum squared resid	423.3413	Schwarz criterion	5.164630	
Log likelihood	-292.0926	Hannan-Quinn criter.	4.701923	
F-statistic	64.66215	Durbin-Watson stat	2.031795	
Prob(F-statistic)	0.000000			

The F-test was used to simultaneously test the correctness of the 2015-2019 Central Java funding work in terms of effectiveness indicators, efficiency indicators, and the suitability of capex and opex for regional financial independence. Table 5 of the regression test, show that the probability value (F-statistic) is 0.00, which means the significant value is $\leq 5\%$ or 0.05. Next, it can be concluded that H_0 is rejected and H_a is accepted. Therefore, the regression model in this study can be used or Fit.

Indicators of effectiveness affect regional financial independence. Based on the test results shown in the table above, the PAD power ratio has a significance value of 0.0352 or < 0.05 . This indicates that H_a is accepted. In other words, efficiency has a partial effect on regional fiscal independence. The ratio of local tax performance can reflect how well a local government achieves local revenue compared to the target set based on the actual

potential of the area (Halim, 2002: 128). A place's independent ability to carry out performance can be categorized as effective with a ratio of 1 or 100%. If the efficiency measure increases in the regional government, it can be concluded that the regional capacity is getting better with the performance that is considered adequate has been proven (Mahmudi, 2007). This statement aligns with research showing that efficiency measures affect regional financial independence (Nurhasanah, 2020). Efficiency indicators involve the degree of regional financial independence. The regression test was carried out according to the results described and the real significance of PAD efficiency with income was 0.0484. This shows that $0.0003 < 0.05$, then accepting this incident leads to a measure of efficiency affecting the freedom of regional funding to a certain extent. The results of this research analysis are in line with previous research that efficiency indicators have a positive effect on regional financial independence. Efficiency metrics measure the use of resources and means to achieve excellence, from low to low. The higher the efficiency ratio, the worse the regional financial performance; conversely, the lower the efficiency ratio, the better the efficiency (Mulyani, 2017). Other research that is in line with current finding also shows that the lower the percentage of PAD collection costs to the efficiency of achieving PAD, the better the welfare of the community (Marizka, 2013).

Investment affects the degree of regional financial independence. Based on the regression test shows a significance value of 0.0103 for investment. If H_a is accepted, it's finished. Because the significance value is $0.0090 < 0.05$. It can be seen that the investment feasibility ratio has a partial effect on regional financial independence. The results analyzed in this study align with previous studies that investment suitability positively impacts regional fiscal independence because regional fiscal independence is an activity related to the acquisition of regional fiscal revenues. Using good investments can help the government increase fiscal independence and efficiency area. Regional funding will also be more efficient and, in addition to investment allocation, can strengthen the impact of financial performance on economic growth (Dinna, 2018; Puspitasari et al., 2015; Sukarmi & Iga, 2016). Ariani & Putri (2016) also found that saving could affect regional funding. Likewise, Simatupang (2016) also discover that positively affected the value of regional funding freedom.

Operating expenses do not affect the level of regional financial independence. Based on the regression test obtained a significance value of 0.1895. So the significance value is $0.5484 > 0.05$, or it is concluded if H_a is rejected. This shows that the operational cost suitability ratio partially does not affect regional financial independence. The results of this study indicate that operational costs do not involve regional financial independence because operating expenditures only explain the provincial government's financing for its operations. However, it cannot demonstrate local governments' ability to carry out their financial management and that operating expenditures in detail do not provide significant regional development. Because operational expenditures only explain employee expenditures, where expenditures on employees are used as rewards, assistance, and funds (Yulia, 2020).

5. CONCLUSION

5.1. Conclusion

The real interest rate does not affect the degree of regional financial independence, and the coefficient value is 0.0352 or <0.05 . This shows that H_a is accepted. In other words, efficiency partially affects regional fiscal independence. Based on the test results in Table 1, the regression test obtained that the PAD efficiency had a significance value of 0.0003. This shows that $0.0003 < 0.05$ then accept H_a . This indicates that the efficiency indicator partially affects regional financial independence. The higher the efficiency ratio, the worse the regional financial performance; conversely, the lower the efficiency ratio, the better the efficiency. Investment affects the degree of regional financial independence. The higher the efficiency, the worse the regional financial performance. Conversely, when the efficiency ratio is low, the efficiency is higher. Then operating costs (significant value of 0.5484) do not affect the regional level of financial independence. So, the significant value is $0.5484 > 0.05$, or if H_a is rejected,. This suggests that the opex compatibility ratio does not partially affect regional fiscal independence, as opex cannot account for the ability of local governments to manage their own finance.

5.2. Limitations and Suggestions

This study was carried out to see the level of regional income with several indicators that influence it by using several tests to prove it. In reviewing the literature through data processing and reviewing previous research, there are limitations to our study. The limitation is the difficulty in the absence of a thorough review to examine operating expenditures that do not affect the level of regional savings in finance, with many local governments still raising nominal capital expenditures to support the financial independence of a region. In addition, no literacy and previous research researched operating spending on the level of regional financial independence. Using expenditures could not explain how local government finances manage their provincial finances. This is because operating expenses cannot provide costs for regional development but only for personnel expenditures. The conclusion that can be drawn is that operating expenses have no effect on a financial value in the independence of a place/region.

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