

# The Influence of Regional Original Income and Capital Expenditure on Regional Financial Independence in Regency/City Governments of South Sumatra Province

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## Abstract

This study aims to determine the effect of local revenue and capital expenditure on the financial independence of local governments in South Sumatra Province. This study uses a quantitative approach and quantitative data types with secondary data sources obtained from the Regional Government's Financial Report (LKPD) of South Sumatra Province for 2021-2023. Data were processed using SPSS and analyzed using multiple linear regression analysis. The results of this study indicate that local revenue influences regional financial independence with a significance value of  $0.00 < 0.05$ , while capital expenditure has a significant negative effect on regional financial independence with a value of  $0.001 > 0.05$ . However, local taxes and regional levies simultaneously influence regional financial independence with a significance value of  $0.00 < 0.05$  and a coefficient of determination of 93.4%.

## Keywords

PAD, Capital Expenditure, Regional Financial Independence



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## INTRODUCTION

Since the advent of the reform era, which brought major changes to various aspects of life in Indonesia, such as social, economic, political, and community aspects, which have given rise to demands for good governance. Therefore, development is necessary in various fields, both at the national and regional levels. In supporting the implementation of national development, Law Number 33 of 2004 concerning Fiscal Balance between the Central and Regional Governments provides opportunities for the implementation of regional autonomy. In Law Number 9 of 2015, regional governments have rights and obligations over their autonomous regions in supervising and controlling community interests and government affairs in accordance with applicable provisions.

Law Number 1 of 2022 concerning Financial Relations between the Central and Regional Governments explains that in implementing regional autonomy, regional governments have the right to utilize and use their regional revenue sources according to community expectations. This is the duty and responsibility of regional governments to fulfill their revenues, which aim to provide services to the community and increase regional potential (Julia et al., 2020). According to Halim (2018), regional financial independence indicates 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. The description of Regional Financial Independence in regional autonomy can be seen from the extent of the region's financial resources to be able to develop its region (Kamaroellah, 2017).

Regional financial independence reflects the level of community participation in regional development. A higher independence ratio indicates higher community participation in paying taxes and levies, which are the main components of Regional Original Revenue (PAD). A higher level of community participation in paying taxes and levies reflects a higher level of community welfare. A common phenomenon in Indonesia today is the relatively small role of PAD in the Regional Budget (APBD). In other words, revenue from the Central Government dominates the APBD structure. Therefore, each region is expected to improve public services and welfare by leveraging its own resources. This will enable the region to carry out all its own governmental affairs, as funding sources have been delegated to the Regional Government. If achieved, the ideal of regional independence can be realized. PAD is a source of funding that is truly sourced from the region itself, reflecting the condition of a region, and the regional government's ability to identify its resources to increase PAD.

Regional revenues are primarily derived from local revenue (PAD), which consists of regional taxes, levies, and the management of separated regional assets. According to Nasir (2019), PAD is the accumulation of tax revenue items, consisting of regional taxes and levies. Regional taxes and levies offer significant potential for growth, as they foster regional governments' independence in meeting their revenue needs. Therefore, professional and transparent management of regional taxes and levies is essential to optimize and increase PAD.

Furthermore, a region's ability to provide funding from within the region in the form of local revenue (PAD) is highly dependent on its ability to realize its existing economic potential. PAD is often viewed as an indicator of a region's dependence on

the central government. A higher PAD will reduce the region's dependence on the central government and is also considered capable of financing regional expenditures, such as operational and capital expenditures. If capital expenditures increase, regional financial independence will increase because more capital expenditures are financed by PAD, thus making the region independent (Wahyuni and Ardini, 2018).

South Sumatra Province is a province in Indonesia located in the southern part of the island of Sumatra. The capital of South Sumatra is Palembang, and at the end of 2023 the province's population was 8,889,913. Observations show that the regional independence ratio of South Sumatra Province has continued to increase from 2020 to 2023, as seen in the following figure: the regional independence ratio has continued to increase from 36.38% in 2020, to 40.22% in 2021, to 49.43% in 2022, and to 52.69% in 2023. This increase in the ratio can be caused by several factors, such as increased receipt of local revenue in the form of regional taxes, regional levies, income from the management of separated assets, and other legitimate income..

## **METHODS**

Basically, a research method is a method that researchers can use in conducting research. Margono (2009:102) states that a research method is a method used by researchers in collecting research data. Research is divided into two, namely qualitative research and quantitative research. According to Evi Martha (2016:1), qualitative research is a type of research that produces findings that are not obtained using statistical procedures. Quantitative research is a process of discovering knowledge that uses data in the form of numbers as a tool to find information about what we want to know. (Margono, 2009:105) This type of research uses associative quantitative research. Associative quantitative research is a type of research that examines the effect of one variable on another variable (Fauzi, 2019). This research also uses a numerical scale or numbers to calculate and interpret data and its processing using statistical tests.

## **FINDINGS AND DISCUSSION**

### **The Influence of Regional Original Income on Regional Financial Independence**

The PAD variable has a calculated t-value greater than the t-table of  $20.613 > 1.675$  and a significance value of  $0.00 < 0.05$ , which means that the PAD variable has a significant positive influence on the regional independence variable. This is in line with research conducted by Bella, et.al (2022), Malau and Simarmata (2020), and

Amalia and Haryanto (2019). One factor indicating regional financial independence is the amount of regional original income. The higher the regional original income, the region is considered capable of financing its own development. Furthermore, higher public participation in paying regional taxes will reflect the people's welfare, thus achieving independence (Nggilu, Sabijono, and Tirayoh, 2021). Through the Stewardship Theory approach, the government, as a steward, acts as a resource manager and is expected to make maximum efforts to improve the welfare of the community as the principal (Lukitawati, 2020). Regional governments strive to maximize regional revenue and its functions through targeted regional tax management and funding in productive sectors that benefit the region in increasing regional income.

### **The Impact of Capital Expenditure on Regional Financial Independence**

The capital expenditure variable has a calculated t-value smaller than the t-table of  $-3.567 < 1.675$  and a significance value of  $0.001 > 0.05$ , which means the capital expenditure variable has a negative effect on the regional independence variable. This is in line with research by Malau and Simarmata (2020) and Senapan and Senapan (2021). Capital expenditure is negatively related to the level of regional financial independence. If capital expenditure is used for public facilities, it will reduce the independence of a region due to the expenditure incurred by the region to finance its needs. Capital expenditure is an expenditure allocated to increase regional assets that have the potential to be a source of regional income. The test results in this study prove that capital expenditure has a negative effect on regional financial independence, meaning that an increase in capital expenditure causes a decrease in regional financial independence. This indicates that the second hypothesis in this study is accepted. This research is in accordance with the signaling theory that local governments provide information on increases in capital expenditure used for the construction of public facilities. The increase in capital expenditure is evidence that local governments prioritize the public interest by building public facilities, although in this case it can cause a decrease in regional financial independence.

### **The Influence of Regional Original Income and Capital Expenditure on Regional Financial Independence**

Based on the results of simultaneous testing, the PAD and capital expenditure variables together have a significant influence on the regional independence variable with a calculated f value greater than the f table, namely  $337.679 > 2.76$  and with a significance value of  $0.00 > 0.05$ . This proves that the third hypothesis, namely that PAD and capital expenditures together have a positive and significant effect on

regional financial independence. Furthermore, the Adjusted R<sup>2</sup> value can increase or decrease if one independent variable is added to the model being tested. The Adjusted R<sup>2</sup> value can be seen in the table above, where the Adjusted R<sup>2</sup> value is 0.934. This means that the independent variables PAD and regional expenditure can explain 93.4% of the regional independence variable, while the remainder is explained by other factors not examined.

Locally-generated revenue (PAD) and capital expenditures indicate regional financial independence. To increase PAD, local governments need to explore their own-source revenue potential by maximizing the potential for regional tax and levy collection to enhance regional financial independence. Furthermore, local-source revenue plays a crucial role in running the government and improving public welfare. Therefore, with high local-source revenue, local governments are considered capable of governing without government intervention (Lukitawati, 2020). Capital expenditure is one way to implement regional autonomy. As stewards, local governments strive to maximize their governance efforts to achieve the goal of improving public welfare by exploiting the potential of existing local resources. Allocating capital expenditure budgets and increasing investment in productive sectors is expected to improve the quality of public services and increase revenue sources for regional revenue (PAD), thus achieving regional financial independence (Saraswati and Nurharjanti, 2021).

## **CONCLUSION**

Regional Original Income (PAD) is proven to have a positive and significant influence on regional financial independence, indicated by a calculated t value greater than the t table ( $20.613 > 1.675$ ) and a significance of  $0.00 < 0.05$ , which means that the higher the PAD, the more capable the region is to finance development independently. Conversely, capital expenditure shows a negative influence on regional independence because the calculated t value is smaller than the t table ( $-3.567 < 1.675$ ), so that increased spending, especially for public facilities, tends to reduce the level of independence due to increased expenditure. Simultaneously, PAD and capital expenditure have a significant influence on regional independence (F count  $337.679 > 2.76$ ; significance 0.00), with an Adjusted R<sup>2</sup> value of 0.934 indicating that the two variables are able to explain 93.4% of the variation in regional financial independence, while the rest is influenced by other factors outside the study.

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