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The Determinants Factors of Regional Financial Independence

Jouzar Farouq Ishak[1,*]

[1] *Politeknik Negeri Bandung, Bandung, Indonesia*
[*] *Corresponding author. Email: jouzar.farouq@polban.ac.id*

ABSTRACT
This study's objective is to examine the determinants of regional financial independence, namely local own-source revenue, balanced fund, and other lawful local revenues. The method used was multiple regression analysis in provincial governments of Maluku and Papua in 2010-2019. The Government of Maluku and Papua Province were chosen as the objects of study because, according to the summary issued by the Directorate General of Fiscal Balance, the Ministry of Finance of Indonesia, these two provinces are those with the lowest regional financial independence ratio compared to other provinces. This study used census techniques by taking all populations as a sample. The data analysis used statistical descriptive analysis. The result indicates that the effect of the determinants factors on regional financial independence is significant. Only the variable of other lawful local revenues has an insignificant impact on regional financial independence. Therefore, the other two factors, local own-source revenue and balanced fund, require more attention from the government in order for the provinces to be financially independent. Institutional strengthening in Maluku and Papua Provinces can be done through organizational restructuring according to regional needs, increase human resource capacity, and modernization of regional taxation administration.

Keywords: *local own-source revenue, balanced fund, other lawful local revenue, regional financial independence.*

1. INTRODUCTION

A large component of the work on public administration reforms in developing countries continues to be centered on institution-building and is encapsulated, in particular, in the notion of capacity enhancement (1). The concept of New Public Management (NPM) is an important issue in public sector reform to achieve good governance since it is related to the problems of public sector performance management. The budget measurement is one of the main principles of NPM (2) (3). Besides, this concept objectives to change the bureaucratic environment that has been seen as complicated, less flexible, and not oriented to the public interest (4).

Bureaucratic reform in Indonesia is one form of NPM which was started with the change of the government system, from centralization to decentralization. This change occurred together with the economic crisis in 1998 which demanded improvement in all areas (5) (6). Decentralization is expected to enable local governments to assume the roles of the central government in all matters except security and defense, law, macroeconomic policy, national planning, and foreign policy (5) (7). Decentralization of revenues and spending is a way to increase efficiency in the public sector, reduce budget deficits, and drive economic growth (8) (9) since the local governments will be more appropriate in meeting the needs of the region than the central government.

However, decentralization causes negative impacts, such as a condition in which local governments respond to unconditional regional expenditures that come from transfers or grants rather than local own-source revenue which will cause inefficient spending (10). This phenomenon occurs because the system of determining balanced funds from the central government to local governments is less effective. The state budget provides balanced funds to local governments in order to be able to carry out public service operations more feasibly, but it makes local governments prioritize spending without considering their ability of financial independence (7). Little research on regional financial independence has been published; recent studies have focused on local own-source revenue (11) (12) (13) (14) (15), balance

fund (16) (17) (18) (19) (20), and other lawful local revenues (21) (22) (23).

This study tries to examine regional financial independence through those three important determinants; own-source revenue, balanced fund, and other lawful local revenues. Especially, the purpose is to assess the effect of revenues on regional financial independence and analyze the determinants of regional financial independence. This study was conducted in the Maluku and Papua Provincial Government since the data show that the regional financial independence ratio of Maluku and Papua in 2017 and 2018 was 6% lower than the other local governments (24). This condition indicates that they have a very low level of independence because their regional incomes have not contributed significantly to their total income. In other words, they are very dependent on funds from the central government in financing regional expenditures.

This study is expected to contribute to the addition of literature and to be the guideline for local governments. It provides information on the importance of increasing the level of local revenue so that the performance of local governments can be maintained properly. By knowing this, local governments can take the right policies of organizing the government in order to run efficiently and effectively. Moreover, this study is expected to be useful to the provincial governments of Maluku and Papua to consider the local government budgets.

This article is arranged in several sections. The first section, Introduction, provides information about the object under study and the problems that occur. In the second section, the relevant discussion about regional financial independence is presented. In the third section, this study discloses the method that is appropriate to meet the research objectives. Further, the results of the data analysis and this study's findings to answer the hypotheses, and the study's position and its relation to other existing research are explained in the fourth section. In the last section, a conclusion is provided, and limitations and potential topics to be addressed in future studies are also presented.

2. LITERATURE REVIEW

Local own-source revenue is the revenue derived from regional sources and is used to finance the implementation of regional autonomy. Local own-source revenue should be pursued to increase and improve the services given to the public (20) (25). The higher the local own-source revenue in a region, the better the ability of the region to implement regional autonomy since it does not have to be fully dependent on the central government (26) (27).

The discussion on the definition of local own-source revenue and its dimensions indicates that local own-source revenue is strongly related to regional financial independence (11) (12) (14). The significant increase in local own-source revenue shows the ability of the region to meet its needs and prosper its people. The public can then stimulate regional economic growth by carrying out investment and spending activities (11). Based on these ideas, the following hypothesis is proposed:

H_1: Local own-source revenue has a positive effect on regional financial independence.

(7) proposes that balanced fund is more dominant in financing the capital expenditure than in local government expenditures. Also, (28) maintains that the fiscal decentralization relationship to economic growth is hump-shaped. The increase in fiscal decentralization gives a positive and significant influence on both the revenue indicators and the expenditure indicators. Capital expenditure is measured and determined based on regional potential and considers the potential of receiving from the central government through balanced funds (29).

(30) reports that local governments that receive balanced funds will treat the funds as local revenue originating from central government and this local revenue will be used for capital expenditure. Regional autonomy accompanied by the provision of balanced funds from local governments should be able to increase the ability of local governments to explore and increase local revenue sources in order to finance public services and improve public welfare (17). Thus, the following hypothesis is formulated:

H_2: Balanced fund has a positive effect on regional financial independence.

Inequality of income distribution will hamper economic growth in poor countries. On the other hand, developed countries encourage economic growth (31). Inequality and economic growth are directly proportional at the initial stage. After passing the peak point of development, inequality and economic growth will be inversely proportional (32).

(33) suggests that fiscal decentralization positively affects the welfare of the community which is manifested in achieving the basic needs of the community. This is in accordance with the argument that fiscal decentralization will make local governments better aware of what people want and need. Besides local own-source revenue and balanced funds, fiscal decentralization also comes from other lawful local revenues. The other local revenue is all revenue except local revenue and transfer revenue, which includes grants, emergency funds, and other local revenues under the provisions of the law. Based on this discussion, the relationship between other lawful local revenue and financial regional independence is hypothesized as follows:

H_3: Other lawful local revenues have a positive effect on regional financial independence.

The regional financial independence ratio is a ratio that measures the extent to which local government depends or relies on external sources of funds such as from the central government or loans (34) (35). If this ratio is low, it indicates the dependence of the local government on external sources of funds is high, which means that the local government is not independent. This ratio is measured using the distribution of total local own-source revenue and central government transfers plus loans (36) (37). Based on this discussion, the relationship between local own-source revenue, balanced fund, other lawful local revenue, and regional financial independence is hypothesized as follows:

H_4: Local own-source revenue, balanced fund, and other lawful local revenue have a positive effect on regional financial independence.

3. RESEARCH METHOD

The study population is local governments of Maluku and Papua Province with a target population are Maluku, North Maluku, Papua, and West Papua Provinces. This study used census techniques by taking all populations as the sample. The Governments of Maluku and Papua Provinces were chosen because, according to the summary issued by the Directorate General of Fiscal Balance, the Ministry of Finance of Indonesia, these two provinces were those with the lowest regional financial independence ratio compared to others. This study used the descriptive quantitative method and secondary data in the form of data pooling.

The data were selected using statistical data set techniques. The data have been collected by other parties who have the authority (the Directorate General of Fiscal Balance, the Ministry of Finance of Indonesia). This study used regression analysis as the analytical method. The measurement of the degree and the character of the connection between dependent and independent variables used multiple regression analysis. The importance of each variable was indicated by the regression coefficients (38).

The classic assumption test was started with testing the model normality to analyze whether the regression model was normally distributed or close to normal. Then, the existence of heteroscedasticity in the data was tested using the Glejser test (39) (40). Besides, the multicollinearity test was employed to identify whether the independent variables had a mutual correlation. If the tolerance value is more than 0.10 and the VIF does not reach 10, there is no multicollinearity between independent variables. The autocorrelation test using Durbin-Watson (DW) was conducted to determine the existence of autocorrelation problems; if dU<DW<4-dL, the autocorrelation on the regression model is not available (39) (40).

In testing the relevance of the capital expenditure determinants, we used a statistical test (38) (39) (41) in the form of a one-tailed test. The criteria of testing are if p-value < 0.05, regional financial independence is not influenced by local own-source revenue, balanced fund, and other lawful local revenue. Otherwise, if p-value > 0.05, regional financial independence is influenced by local own-source revenue, balanced fund, and other lawful local revenue.

4. RESULT AND DISCUSSION

Residual value (error) that spreads normally is one indication that the regression equation obtained is good. It can be concluded that the chance of getting a residual value of around zero is greater than the value of the opportunity far from zero. The analysis of normality of residual values was conducted using the Kolmogorov-Smirnov test, by paying attention to the results of significance values (sig. Z) that is greater than the value of $\alpha = 0.05$. Test results show that the value of significance (sig. Z) is 0.200. It is greater than the value of $\alpha = 0.05$ which means the assumption of normality is fulfilled.

The linearity test was conducted on the relationship curve in each path. The test was done using SPSS on the regression menu followed by sub-menu curve estimation and active linear model options. When the F test gives a significant result (p-value<0.05), it means the linearity assumption is met. The linearity test result has a p-value smaller than 0.05. It can be concluded that the assumption of linearity qualifies.

Table 1. Test results

	Coefficient		Collinearity Test		VIF	Durbin-Watson Test
	B	t	Sig	Tolerance		
Constant	0.183					
Local Own-Source Revenue	1.252	9.107	.000	.342	2.927	1.321
Balanced Fund	-.660	-5.800	.000	.498	2.008	
Other	-.188	-1.292	.205	.303	3.296	

The results of data processing show that local own-source revenue, balanced funds, and other lawful local revenue influence regional financial independence. This study shows there is a positive and influential relationship between local own-source revenue and regional financial independence. This study supports several studies (11) (12) (14). The ratio of regional financial independence is indicated by the ratio of local own-source revenue to total income. The governments that have a good level of independence are those that have a high local own-source revenue ratio and a low transfer ratio.

Institutional strengthening in Maluku and Papua Provinces can be a solution to increase regional financial independence through organizational restructuring according to regional needs, increasing human resource capacity, and modernization of regional taxation administration. The constraint is the lack of human resources who have expertise in the field of taxation, especially tax assessors and bailiffs. Improving human resource insight is also needed through civil servant activities in every training, workshop, Focus Group Discussion (FGD), and other forums. With various efforts made by Maluku and Papua Provinces, it is expected to increase local own-source revenue so that regional dependence on balance funds from the central government can be reduced. Innovation carried out by the region in an effort to increase regional revenues will be another key to success. Optimization of the potential that exists in the area is needed to be able to improve the welfare of the public.

Secondly, this study shows that the variable of balanced fund is significant to regional financial independence. This finding is in accordance with the findings of (16) & (19). The meaning of the transfer ratio to total income is the same as the meaning of the balanced fund ratio; the greater the transfer ratio, the lower the regional independence. On the other hand, the lower the transfer ratio, the higher the level of regional independence or the lower the level of regional dependence on central funds (16). The influence of balanced funds on regional financial independence is one of the external assistance received by a region to meet the needs of government programs if it has a deficit so that the level of regional financial independence will continue to increase if the original regional income is greater than the balanced fund.

Finally, this study shows that other lawful local revenues give an insignificant impact on regional financial independence. This finding is in contrast to (22)'s study in West Java Province which reveals a significant impact of other lawful local revenue on regional financial independence. (23) says that the other lawful local revenue is income obtained from the government if an area experiences a lack of costs or disasters, if the provincial government has funds sourced from other lawful local revenues then the provincial government can not be said to be independent. Therefore, other lawful local revenues give a negative insignificant impact on the regional financial independence. Thus it is not a regional determinant of financial independence in this study.

5. CONCLUSION

New public management is a new paradigm in public sector management as a result of the emergence of a welfare state crisis. New Public Management is applied not only in countries with high prosperity levels but also in developing countries. This study can conclude several things. First, local own-source revenue has an effect on regional financial independence. Regional revenue in the structure of financial statements consists of regional income and regional financing. The second conclusion is that the balanced fund has an effect on regional financial independence. Balanced funds are funds sourced from state budgets that are allocated to regions to fund regional needs in the context of implementing decentralization. In general, the proportion of regional original revenues is higher than the balanced funds. Lastly, other lawful local revenues have no effect on regional financial independence. The sources of income originating from other legitimate income are not up to 1 percent so that regional needs cannot be fully covered because the percentage is very small.

Although this study can bring up some contributions, there are still limitations. This study focuses on provincial governments in the Maluku and Papua regions, Indonesia. The sample used in this study is only representative of the provincial government in Maluku, North Maluku, Papua, and West Papua Province. Consequently, the results of this study should not be overgeneralized to all local governments. To gain a better result, future studies could use sample data from other provincial governments in Indonesia. This study also has limitations in terms of variables included in the regional financial independence. Other variables such as tax ratio, fiscal space, growth, and expenditure of use were reported to also affect regional financial independence.

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