

Local government financial performance: the effects of capital expenditure and intergovernmental revenue (The case of South Sumatra Province, Indonesia)

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Abstract

The main purpose of this study is to examine the effects of capital expenditure and intergovernmental revenue on local government financial performance in South Sumatra Province, Indonesia. The result is expected to extend the knowledge about local government financial performance and different relevance of financial performance factors. Data on seventeen districts/cities in South Sumatra Province during 2014-2018 were used to test the research model. The data is sourced from the financial reports of the district/city government of South Sumatra province and the Central Statistics Agency. The analytical results showed that capital expenditure is statistically positive and has a significant effect on the financial performance of local governments. Meanwhile, the intergovernmental revenue is negative and significantly affects local government financial performance. Future studies should consider various variables that may influence the financial performance of local governments. Future studies could also use different methodologies such as focus groups and interviews.

Keywords: *Local government, Financial performance, Capital expenditure, Intergovernmental revenue*

JEL Classification: H72, H77

INTRODUCTION

One of the reform agendas and improvement of the local government performance in Indonesia is to encourage delegation as the central government's authority for financial management to local governments. The objective is for the local governments able to finance development and services on a financial basis. In addition, local governments must also provide services that are more oriented towards satisfaction and the needs of the public regarding the performance of local governments (Patrick, 2007; Pirade, Mus, Mas'ud & Nur, 2018).

The decentralization and local government autonomy policies stipulated in Law No.32/2004 article 1 point 5 states that local government autonomy is the right, authority, and obligation of an autonomous region to regulate and manage government affairs and the interests of local communities under statutory regulations. Local

governments are given the discretion to explore revenue sources that come from the potential that exists in their area.

To support the implementation of national development, the Indonesian government provides the opportunity to implement local autonomy by issuing Law Number 12 of 2008 concerning the second amendment to Law Number 32 of 2004 concerning Regional Government and Law Number 33 of 2004 concerning the financial balance between the central government and local government. The main objective is to provide the local government with rights and obligations to organize and manage government affairs and the local community's interests under statutory regulations.

In the preparation of the local government budget, capital expenditures must be adjusted to the needs of the local government by considering the local own-source revenue. Thus, if the local government plans to increase capital expenditures for public services and welfare, the local government must explore local own-source revenue as much as possible (Pirade et al., 2018; Sularso & Restianto, 2012).

According to the Regulation of the Minister of Home Affairs Number 13 of 2006 concerning guidelines for local financial management, it explains the classification of regional expenditures, which states that regional expenditure groups according to programs and activities consist of direct expenditure and indirect expenditure. The direct expenditure group is the expenditure budgeted directly related to the implementation of local government programs and activities comprised of three components, namely: (1) Personnel Expenditures, (2) Goods and Services Expenditures, and (3) Capital Expenditures.

Halim & Kusufi (2014) state that capital expenditure is local government expenditure. Its benefits exceed one fiscal year, increase local assets, and add routine expenditures such as maintenance costs in the general administration expenditure group.

High capital expenditure is a reflection of the many infrastructure and facilities built. Thus, a widely implemented development will improve services to the public and the performance of local governments (Siregar, 2012; Wong, 2004). High capital expenditure will improve financial performance (Sularso & Restianto, 2012). In terms of the local government size, the size of the regional area indicated by the large population, it is expected that the performance of the local government will be higher. Therefore, the large size of the local government will also improve the financial performance of the local government (Sularso & Restianto, 2012; Susilowati & Kristianto, 2016).

Local governments receive intergovernmental revenue from external sources and do not require repayment (Setyaningrum & Febriyani 2012). Intergovernmental revenue is commonly known as fiscal balance transfers from the central government to regions (Simanulang, 2013). The fiscal balance transfers result from the central government's policy in the fiscal decentralization for fiscal balance between the center and the regions, which consists of the revenue sharing fund, general allocation fund, and special allocation fund.

The fiscal balance transfers also aim to reduce the gap in government funding between regions and increase local capacity in exploring regional economic potential (Simanullang, 2013). The central government will monitor the distribution of fiscal balance transfers. Thus, the high fiscal balance transfers will increase the supervision of the central government, so it will make local governments more careful in implementing their work programs. It will encourage local governments to improve their performance as a form of accountability for their financial management since the source of finance comes from external parties (Sasotyningtyas, 2012).

Intergovernmental revenue may affect the financial performance of local governments. High intergovernmental revenue will increase the central government's

control (Marhawai, 2015). Thus, local governments will be more careful in implementing their work programs. Therefore, the greater the intergovernmental revenue will make the performance of local government finances better.

Government Regulation Number 29 of 2014 concerning the performance accountability system of government agencies reveals that performance is the output/result of activities/programs that have been or are about to be achieved in connection with the use of a budget with measured quantity and quality. Halim and Kusufi (2014) state that to ensure that the programs and activities that have been determined are carried out properly and follow organizational goals, a management control system is necessary. Performance control consists of evaluating the performance of programs and activities that have been implemented under predetermined performance benchmarks. Performance measurement systems are needed to formulate appropriate performance benchmarks. Performance measurement is a tool for management to assess the organization's success (Halim & Kusufi, 2014; Rahmawati & Putra, 2016). In public sector organizations, organizational success is measured by the ability of the organization to provide the best and quality public services. The benefits of performance measurement for government organizations are Monitoring and evaluating performance achievement, comparing it with performance targets, and taking corrective action to improve performance. And also as a communication tool between subordinates and leaders to improve organizational performance (Mardiasmo, 2002).

As a party with more information, especially financial information, the government is expected to realize transparency towards the people's expectations and trust (Nosihana & Yaya, 2016). Stewardship theory can explain the existence of local government (steward) as an institution that can be trusted and accommodate community aspirations. And provide good information and services to the public and generate financial accountability so that economic objectives can be achieved and the community's welfare can be increased. If the local government achieves this goal as the steward, then the community as the principal will be satisfied with the government's performance (Nosihana & Yaya, 2016). Stewardship theory views that there is no situation where management is motivated for individual goals but more focused on the organization as the main goal (Donaldson & Davis, 1991)

Several earlier studies have been carried out on capital expenditures and intergovernmental revenue on financial performance. However, the results showed inconsistencies. Previous studies from several countries such as Slovenia (Pevcin, 2012), Turkey (Aydın, Akıncı, & Yılmaz, 2016), Ghana (Frank & Ishmaell, 2014), and Nigeria (Patricia & Izuchukwu, 2013) found a significant effect between government expenditure and revenue on performance. Meanwhile, different results were found from studies conducted by Fasoranti (2012), Egbetunde and Fasanya (2014), and Adefeso (2016), where government expenditure and revenue do not affect the performance.

Moreover, previous studies found that capital expenditure and intergovernmental revenue significantly affect financial performance in Indonesia (Ilmiyyah, Dewata, Sartikadarwati 2017; Istia & Hardiyanto, 2015; Marhawai, 2015, Sari, 2016). However, the results of previous studies such as Malendra, Meihendri, and Yunilma (2015), Retnowati (2016), and Sasotyanningtyas (2012) indicate that the capital expenditure and intergovernmental revenue have no significant effect on financial performance.

The inconsistency of previous studies related to financial performance triggers further research. Therefore, the current study aims to re-examine the effect of capital expenditure and intergovernmental income on local government financial performance, particularly in South Sumatra Province.

METHODS

The method used in this study is quantitative research methods. The sample used in this study is all of the population, namely all regency and municipal governments in South Sumatra Province, totaling 17 regencies/municipals between 2014-2018. The data processed in this study are the Report on Local Government Finances of the regency/municipal government of South Sumatra Province and data from the Central Bureau of Statistics. The data analysis technique is multiple regression analysis, with the following models:

$$\ln FP = \beta_0 + \beta_1 CE + \beta_2 IR + \epsilon_i$$

Where:

FP = Local Government Financial Performance

CE = Capital Expenditure

IR = Intergovernmental Revenue

Capital Expenditure is Expenditures for the acquisition of fixed assets and other assets that benefit more than one accounting period. Capital expenditures include, among others, capital expenditures for the acquisition of land, buildings and buildings, equipment, and intangible assets. It is presented in Log natural (Ln).

Intergovernmental Revenue is measured through the General Allocation Fund divided by Total Revenue. Furthermore, Local Government Financial Performance is measured through Local Own-source Revenue divided by Central Government Assistance/Provincial Government + Loans.

RESULT AND DISCUSSION

The Capital Expenditure from the regional government in the regency/municipal of South Sumatra Province with the lowest expenditure is in Pagaralam City, Rp 25.25 billion (Table 1). The highest value is in Musi Banyuasin of Rp 27,95 billion. Regency/municipal experienced increased capital expenditure per year is 7 regencies/municipal. Meanwhile, the 10 regency/municipal that experienced a decrease in capital expenditure per year.

Table 1. Regency/city capital expenditure in South Sumatra Province, 2014 - 2018

No	Local Government	Low (billion Rp)	High (billion Rp)	Mean (billion Rp)	Growth/ year %
1	Banyuasin	26.31	27.21	26.68	-1.46
2	Empat Lawang	26.02	26.62	26.25	-1.00
3	Lahat	26.46	26.88	26.64	0.91
4	Muara Enim	27.00	27.18	27.08	-0.20
5	Musi Banyuasin	26.74	27.95	27.30	-4.35
6	Musi Rawas	26.61	26.75	26.67	-0.05
7	Musi Rawas Utara	26.36	26.60	26.51	-0.43
8	Ogan Ilir	26.13	26.57	26.45	0.11
9	Ogan Komering Iir	26.43	27.05	26.82	0.24
10	Ogan Komering Ulu	25.85	26.52	26.29	-1.00
11	Ogan Komering Ulu Selatan	26.40	26.51	26.53	0.50
12	Ogan Komering Ulu Timur	26.06	26.40	26.30	-0.54
13	PALI	26.19	27.16	26.62	1.05
14	Lubuk Linggau	26.05	26.41	26.16	-1.18
15	Pagaralam	25.25	26.44	26.05	-0.34
16	Palembang	27.08	27.48	27.27	0.06
17	Prabumulih	25.51	26.58	26.10	-0.60

Source: Local Government Budget Reports Year 2014-2018

Table 2 shows that the ratio of intergovernmental revenue from regency/municipal governments in South Sumatra Province with the lowest percentage is in Palembang, 50.9%, while the highest is in Musi Banyuasin at 90.7%. The regency/municipal that experienced an increase in the intergovernmental revenue per year are 4 regencies/cities. Meanwhile, regency/municipal that experienced a decrease are 13 regencies/cities.

Table 2. Regency/city intergovernmental revenue in South Sumatra Province, 2014 - 2018

No	Local Government	Low %	High %	Mean %	Growth/year %
1	Banyuasin	69.67	77.64	72.71	-0.62
2	Empat Lawang	76.03	82.37	77.92	-1.82
3	Lahat	61.42	75.63	68.13	-0.69
4	Muara Enim	70.97	82.07	76.89	-3.40
5	Musi Banyuasin	79.46	90.73	85.90	-3.15
6	Musi Rawas	74.82	81.83	78.89	-1.86
7	Musi Rawas Utara	77.89	84.46	81.84	-1.38
8	Ogan Ilir	74.08	85.57	75.94	-3.08
9	Ogan Komering Iir	70.45	81.09	74.79	-2.83
10	Ogan Komering Ulu	72.96	82.01	76.47	-2.73
11	Ogan Komering Ulu Selatan	71.29	88.58	76.95	-4.95
12	Ogan Komering Ulu Timur	69.38	80.26	74.08	-2.28
13	PALI	66.27	85.23	79.40	6.64
14	Lubuk Linggau	70.86	81.45	76.36	1.06
15	Pagaralam	69.55	83.76	76.85	3.36
16	Palembang	50.90	57.10	55.26	2.39
17	Prabumulih	71.15	79.43	76.22	-0.49

Source: Local Government Budget Reports Year 2014-2018

Based on Table 3, the lowest value of the financial performance of regency/municipal governments in South Sumatra province is in Pali, which is 2.8%, while the highest value is in Palembang of 47.3%. Meanwhile, the regency/municipal that experienced an increase in the financial performance are 14 regency/municipal. Those experiencing a decrease in financial performance are 3 regencies/municipal.

Table 3. Regency/city local government financial performance in South Sumatra Province, 2014 - 2018

No	Local Government	Low %	High %	Mean %	Growth/year %
1	Banyuasin	5.70	7.20	6.50	1.48
2	Empat Lawang	2.92	8.24	4.59	22.04
3	Lahat	6.42	13.07	10.33	-7.01
4	Muara Enim	8.60	12.40	10.47	11.44
5	Musi Banyuasin	5.90	9.83	7.98	15.24
6	Musi Rawas	6.64	11.90	8.78	-6.88
7	Musi Rawas Utara	3.47	7.93	4.92	12.15
8	Ogan Ilir	4.00	11.00	6.74	23.14
9	OKI	6.81	14.80	11.02	16.26
10	OKU	8.24	14.09	10.92	15.42
11	OKU Selatan	3.65	9.83	5.18	23.63
12	OKU Timur	5.47	6.46	5.94	-1.73
13	PALI	2.80	7.01	4.70	29.04
14	Lubuklinggau	6.60	13.36	10.56	21.80
15	Pagar Alam	6.20	10.58	8.01	15.77
16	Palembang	34.68	47.30	38.74	4.67
17	Prabumulih	7.90	15.39	10.79	12.23

Source: Local Government Budget Reports Year 2014-2018

Table 4 shows that the average financial performance of regency/municipal government in South Sumatra Province as measured by the independence ratio is 9.77%, with a standard deviation of 7.99448. Based on the criteria for the independence ratio with a value between 0%-25% is very low, 25% - 50% is low, and more than 50% is considered good. Thus, based on the criteria, the financial performance of the regency/municipal government in South Sumatra Province is considered very low. Based on table 4, the average capital expenditure of regency/municipal government in South Sumatra Province for 5 years is 26.5724, and a standard deviation is 0.44469. In Table 5, the intergovernmental revenue of the regency/municipal government in South Sumatra Province has an average value of 75.56%, with a standard deviation of 7.604%.

Tabel 4. Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Capital Expenditures	85	25.25	27.95	26.5724	.44469
Intergovernmental Revenue	85	.51	.91	.7556	.07604
Financial performance	85	2.80	47.30	9.7753	7.99448
Valid N (listwise)	85				

The test results based on One-Sample Kolmogorov Smirnov show that the K-S value is 0.200 with data (N) 85 (Table 5). Samples with a significant value above 0.05 or 5% indicate that the residual value is normally distributed and may proceed to the following analysis.

Table 5. One Sample Kolmogorov Smirnov Normality Test Results

		Unstandardized Residual
N		85
Normal Parameters ^{a,b}	Mean	.0000000
	Std. Deviation	5.49930481
Most Extreme Differences	Absolute	.084
	Positive	.084
	Negative	-.043
Test Statistic		.084
Asymp. Sig. (2-tailed)		.200 ^{c,d}
a. Test distribution is Normal.		
b. Calculated from data.		
c. Lilliefors Significance Correction.		
d. This is a lower bound of the true significance.		

Based on the coefficient analysis (Table 6), it can be shown that the Capital Expenditure variable has a regression coefficient of 2.839, with a significance of 0.040. So, it can be explained that capital expenditure has a positive and significant effect on the financial performance of local governments. This means that for every increase in capital expenditure by one unit, the financial performance of the local government will also increase by 2.839% with the assumption that other independent variables have a fixed value.

Meanwhile, the Intergovernmental Revenue variable shows a negative regression coefficient of -41.212 with a significance of 0.000. Then, it can be explained that intergovernmental revenue has a significant negative effect on the financial performance of local governments. This means that for every increase in intergovernmental revenue by one unit, the financial performance of the local government will also decrease by -41.212%, assuming other independent variables have a fixed value.

Tabel 6. Coefficients analysis

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-17.108	15.341		-1.115	0.268
Capital Expenditures	2.839	1.358	0.184	2.091	0.040
Intergovernmental Revenue	-41.212	6.902	-0.504	-5.971	0.000

Capital expenditure has a positive and significant effect on local government financial performance. The results are supported by previous studies, such as Frank & Ishmaell (2014), Udoka & Anyingang (2015), Aydin et al. (2016), and Kayode, Kuranga, & Lukman (2015). (2015), the overall expenditure made by the government has a positive impact on the performance. In contrast, Egbetunde & Fasanya (2014), Adefeso (2016), and Amuka, Ezeoke, & Asogawa (2016) found that not every government expenditure can increase performance.

Based on the results, it shows that capital expenditure has contributed to the performance of local government. Capital expenditures of local governments are used to finance programs, activities, and projects to improve public services and interests. The implemented capital expenditure activity is a form of investment by local governments. The allocation of high capital expenditures may help the public develop and obtain financial sources that are useful for increasing local income. The availability of good infrastructure can create efficiency across various sectors, increase public productivity, and increase welfare. Meanwhile, if the local government implements more developments, it can also increase the growth of local government financial performance.

The intergovernmental revenue has a negative and significant effect on local government financial performance. The results differ from the previous studies, among others Pevcin (2012), Rao (2017), and Masaki (2018), where intergovernmental has a positive and significant impact on improving performance and also has a role in providing public services.

The statistical analysis results indicate that the financing of regency and municipal government activities in South Sumatra Province still relies on funding from the central government. Regency and municipal governments in South Sumatra Province are still unable to explore and utilize the existing regional potential to increase local own-source revenue. It is based on the number of local own-source revenue of regency and municipal governments in South Sumatra province, which are still lower when compared with the general allocation fund.

This condition must be corrected immediately because the emergence of decentralization or regional autonomy gives local governments an obligation to manage and organize the management of their respective local governments. The general allocation fund aims to equalize financial capacity among regions in implementing decentralization. However, this does not mean that the general allocation of funds transfer from the central government can be used as the main regional funding source, especially for regency and municipal governments in South Sumatra Province. Thus, regency and municipal governments in South Sumatra Province also receive demands to explore the local potential and increase local own-source revenue to implement government independently.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The capital expenditure variable has a positive and significant effect on the financial performance of local governments. It can be concluded that the regency and municipal governments in South Sumatra Province have optimized capital expenditure as a source of contribution to the performance of local government management. The intergovernmental revenue has a negative and significant effect on local government financial performance. Thus, the high value of intergovernmental revenue held by regency and municipal governments in South Sumatra Province will reduce financial performance as measured by the level of local government independence.

Moreover, the findings show that the financing of regency and municipal government activities in South Sumatra Province tends to rely on the central government and has not been able to explore existing regional potentials to increase local revenue.

Recommendations

This study indicates that the allocation of capital expenditures can improve local government performance because the absorption of capital expenditures affects development and community welfare. Therefore, it is suggested that the contribution of capital expenditure should be increased to improve development and community welfare in South Sumatra Province.

Capital expenditure and intergovernmental income are key factors that can affect the financial performance of local governments. However, intergovernmental revenues have a negative effect on local government financial performance. Thus, it is necessary to develop instruments that can increase the regional potential to increase the performance of local governments.

Future study is suggested to use other independent variables that may influence the financial performance of local governments, increase the period and the object of study to improve the accuracy of the quality of results. Future studies could also use different methodologies such as focus groups and interviews.

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