The Level of Regional Financial Independence as One of the Benchmarks for Government Performance in Indonesia

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ABSTRACT

Introduction/Main Objectives: Indonesia faces global phenomena and also domestic issues that affect commodity prices and ultimately impact the level of regional independence. **Background Problems:** The independence of each region in Indonesia needs to be supported and the driving factors explored so that each region can develop by relying on the resources available in their respective areas without depending on transfers from the central government. This study aims to examine the influence of balancing funds, local revenue, and economic growth on the level of regional independence. **Novelty:** This research was analyzed using panel data regression, which differs from previous studies. **Research Methods:** This research is a quantitative study with a descriptive-verificative approach. Data were analyzed using panel data regression analysis**.** The population of this study consists of all provinces in Indonesia. The sampling technique used was purposive sampling, resulting in 34 out of 38 provinces with complete data. **Finding/Results:** The results of this study indicate that balancing funds, local revenue, and economic growth have an impact on the level of regional independence in Indonesia. **Conclusion:** Higher balancing funds can improve community welfare, thereby increasing the level of regional independence. The increasing local revenue will make the region less dependent on the central government, thereby raising the level of regional independence. If economic growth includes the economy in each region, it can also increase regional income, thereby raising the level of regional independence.

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1. Introduction

Indonesia needs to be vigilant against global phenomena where the uncertain global economic situation, such as the ongoing trade war between the United States and China, the Brexit polemic, the weakening economic growth in several countries like Germany, Argentina, and Singapore, and the decline in China's current account surplus. A number of these risks could potentially suppress global trade volume and economic growth, thereby affecting commodity prices. In addition to global phenomena, there are concerns from internal factors such as trade balance deficits, a large income gap, and slowing economic growth. Efforts to find new sources of economic growth need to be undertaken, such as providing opportunities for the development of regional economic potential. If the sources of regional economic growth can increase from the primary, secondary, or tertiary sectors, it is expected to enhance regional independence (Dhimas Ginanjar, 2019).

The increase in regional financial independence and the reduction of fiscal dependence on the central government are the goals of fiscal decentralization. In practice, many regions still rely on central government funding for local development. The problem faced by the regions today is how to increase local revenue without harming or burdening the community. What needs to be avoided is an increase in regional original revenue that causes suffering to the people. The increase in regional autonomy is closely related to the region's ability to manage its original regional revenue. The higher the region's ability to generate local revenue, the greater the region's capacity to utilize that local revenue in accordance with the aspirations, needs, and development priorities of the region. The principle is that regional original revenue aims to grant authority to local governments to fund the implementation of regional autonomy in accordance with the region's potential as a manifestation of decentralization (Rizan, 2019).

If the level of regional financial independence increases, the region's dependence on government and provincial assistance decreases. Regional financial independence also reflects the level of community participation in regional development, meaning that the higher the regional financial independence, the greater the community's participation in paying local taxes and levies. If the level of regional financial independence is higher, it means that the local government has been able to enhance the financial capacity originating from the local area (Rizan, 2019).

Seeing the importance of regional independence as one of the benchmarks for government performance in a country that has successfully opened up space for each of its regions to grow and develop without relying on transfer funds from the central government, the purpose of this research is:

1. To determine the influence of balancing funds on the level of regional independence in Indonesia.
2. To determine the influence of local revenue on the level of regional independence in Indonesia.
3. To determine the influence of economic growth on the level of regional independence in Indonesia.

Previous research examining the impact of balancing funds on regional autonomy, such as Machfud et al (2020) and Ginting (2019), states that balancing funds influences the level of regional autonomy. Saraswati and Nurharjanti (2021) state that balancing funds does not have an impact on the level of regional independence. Previous research shows varying results.

Previous research examining the influence of local revenue on the level of regional independence, such as Gaghana et al (2018), Tolosang (2018), Machfud et al (2020), and Wahyuni and Ardini (2018), states that local revenue affects the level of regional independence. On the other hand, according to Ijtihad and Harsono (2024), regional income does not affect the level of regional independence. Previous research results show varying outcomes.

Previous research examining the impact of economic growth on regional autonomy levels, such as Gaghana et al (2018) and Tolosang (2018), states that economic growth does not affect regional autonomy levels. There haven't been many previous studies examining economic growth as an independent variable linked to regional autonomy as a dependent variable.

2. Literature Review

2.1 level of regional independence

According to Prakoso et al (2019), the pattern of relationship between the central government and local governments must be conducted with the financial independence of local governments in financing the implementation of governance and development, although measuring the financial capacity of local governments will result in differences. According to Tanan and Duri (2018), the regional independence ratio is calculated by comparing the amount of local revenue receipts with the amount of transfer revenue from the central and provincial governments, as well as regional loans. The higher this ratio indicates, the greater the regional government's financial independence. According to Yulihantini et al (2018), local governments finance their own development.

According to Purbandari (2019), this ratio illustrates the level of a region's dependence on external funding sources. If the independence ratio is higher, it means the region's dependence on external assistance (especially from the central and provincial governments) is lower. If the independence ratio is higher, then the community's participation in paying taxes and regional levies, which are the main components of PAD, will also be higher. According to Woestho et al (2020), if the level of financial independence of a region increases, it means that the participation of the community in paying taxes and local levies, which are components of local revenue, also increases. Thus, it can be concluded that the level of regional independence is the ability of a region to not rely on others in terms of regional development in various aspects.

2.2 Balancing Fund

According to Fatimah et al (2020), balancing funds are funds aimed at creating financial balance between the central and regional governments and among regional administrations. The balancing fund consists of revenue-sharing funds from tax and natural resource receipts, general allocation funds, and special allocation funds. According to Ferdiansyah et al (2018), the balancing fund consists of revenue sharing fund, general allocation fund, and special allocation fund.

According to Machfud et al (2020), balancing funds have a negative and significant impact on the regional financial independence ratio. Therefore, it is recommended that local governments optimize the use of balancing funds to avoid excessive dependence on central transfer funds, which can be achieved by building infrastructure and improving education and health facilities, as these measures can have a positive effect on regional financial independence. It can be concluded that balancing funds are funds aimed at equalizing finances between the central government and regional governments, as well as among regional governments. The balancing funds consist of general allocation funds, special allocation funds, as well as funds derived from tax revenues and natural resources. Thus, the first hypothesis in this study is as follows:

H_1 : Balance funds had an impact on the level of regional independence

2.3 Local Revenue

According to Anynda and Hermanto (2020), local revenue is the legitimate revenue managed by the region to implement regional autonomy. The higher the role of local revenue in the overall regional income, the more it reflects the success of efforts and the level of capability in financing the administration of government and regional development. According to Buka dan Hiola (2021), local revenue is the income obtained by the region from sources within its own territory, collected based on regional regulations in accordance with applicable laws and regulations.

According to Nasir (2019), local revenue is essentially intended for the development of each region so that its benefits can be felt by the entire community of that region. It can be concluded that local revenue is the money received by the region from sources within its territory, collected in accordance with applicable regional regulations. The main objective of local revenue is to develop each region so that all its communities benefit from it. Thus, the second hypothesis in this research is as follows:

H_2 : Local revenue had an impact on the level of regional independence

2.4 Economic Growth

According to Yunianto (2021), economic growth is a process of continuous improvement in a country's economic conditions over a certain period, while according to Simanungkalit (2020), economic growth is the increase in national income or production in a country year after year. As for measuring economic growth, it can be done using Gross Domestic Product (GDP). Gross Domestic Product (GDP) is the total production of goods and services produced at a specific time in a particular country or region.

If the income received by the local government increases, it will be better because it positively affects the financing of economic development in the region, meaning that government spending on economic development will also increase, ultimately leading to economic growth (Arina et al., 2019). It can be concluded that the increase in national income or production of a country each year is known as economic growth, which is a process of gradually improving the economic conditions of a country over a certain period. Thus, the third hypothesis in this study is as follows:

H_3 : Economic growth had an impact on the level of regional independence

3. Method, Data, and Analysis

The population of this study consists of all provinces in Indonesia, totaling 38 provinces, and the research period spans from 2018 to 2023. This research period was deliberately chosen because it is considered long enough to capture changes, fluctuations, and variations in regional conditions, especially those related to economic, social, and institutional development across provinces. By covering six years of observation, the analysis becomes more representative and provides a broader perspective on the trends being studied. The chosen period also allows the researcher to observe the effects of policy shifts, economic cycles, and external shocks, thereby enriching the interpretation of results.

The sampling technique used is purposive sampling, where samples are taken based on the specific criterion that the provinces must have complete and consistent data required for this research throughout the entire research period. Provinces that do not meet this requirement were excluded, as incomplete data could reduce the validity, reliability, and overall accuracy of the findings. This approach ensures that the final dataset is robust and can be analyzed without major concerns about missing values.

This research is categorized as a quantitative study with a descriptive-verificative approach, meaning that it does not merely describe the characteristics of the collected data but also tests hypotheses and verifies causal relationships between the observed variables. To process the data, panel data regression analysis was employed using Eviews software, which is well known for its ability to handle both time series and cross-sectional data effectively. Prior to conducting the regression analysis, several classical assumption tests were carried out, namely the normality test, heteroscedasticity test, and multicollinearity test, with the aim of ensuring that the regression model is statistically valid, unbiased, consistent, and efficient in generating reliable estimators. The use of these procedures strengthens the credibility of the research findings and ensures that the conclusions drawn are scientifically sound.

The operationalization of the research variables is as follows:

Table 1. Operationalization of Variables

Variable	Definition	Indicator	Data Scale
X_1 Balancing Fund	Funds aimed at creating financial balance between the central and regional governments (Fatimah et al., 2020)	Revenue Sharing Fund + General Allocation Fund + Special Allocation Fund	Ratio
X_2 Local revenue	Revenue obtained by the region from sources within its own territory, collected based on regional regulations in accordance with applicable laws and regulations (Buka dan Hiola, 2021)	The amount of local revenue	Ratio
X_3 Economic growth	The process of continuously improving a country's economic conditions over a certain period (Yunianto, 2021)	Gross Domestic Product (PDB)	Ratio
Y Level of Regional Independence	The ability of local governments to finance their own development (Yulihantini et al., 2018)	$\frac{\text{The amount of local revenue}}{\text{Balancing fund}}$	Ratio

Sources: Data processing results (2024)

4. Result and Discussion

Before conducting panel data regression, classical assumption tests (heteroscedasticity test and multicollinearity test) are first performed. The normality test is not conducted because it is not fundamentally a requirement for BLUE (Best Linear Unbiased Estimator), and according to several opinions, it is not mandatory to perform this normality test (Basuki dan Prawoto, 2019).

The results of the heteroscedasticity test can be shown in the following table:

Table 2. Results of the Heteroscedasticity Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.024391	0.016783	1.453290	0.1480
X1	7.51	7.15	1.050206	0.2951
X2	1.53	2.56	0.600192	0.5492
X3	-4.74	3.86	-1.228733	0.2209

Sources: Eviews data processing results (2024)

Based on Table 2, the probability value is greater than 0.05. This indicates that there is no issue of heteroscedasticity. The results of the multicollinearity test are shown in the table below:

Table 3. Multicollinearity Test Results

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.001046	61.75462	
X1	1.90	48.36206	1.129569
X2	2.43	114.2465	2.868014
X3	5.52	86.61632	2.794630

Sources: Eviews data processing results (2024)

Based on Table 3, the centered VIF values are all less than 10. This indicates that there is no multicollinearity problem, meaning that the independent variables used in the model are not highly correlated with each other and can therefore provide reliable estimations in the regression analysis. In choosing the best method to use, the author conducted the Chow Test and the Hausman Test. The Chow Test was performed to determine whether the common effect model or the fixed effect model is more appropriate, while the Hausman Test was carried out to decide between the fixed effect model and the random effect model. Both tests are important in panel data analysis because they guide the researcher to select the most efficient and consistent estimation technique. A proper model selection ensures that the panel regression results are accurate and not biased, thus allowing the interpretation of the relationship among variables to be more precise. Here are the test results:

Table 4. Chow Test Results

Effects Test	Statistic	d.f.	Prob.
Cross-section F	42.755713	(33,167)	0.0000
Cross-section Chi-square	458.159668	33	0.0000

Sources: Eviews data processing results (2024)

Table 5. Hausmann Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	50.398784	3	0.0000

Sources: Eviews data processing results (2024)

The Chow test examines which method is better, namely, the common effect and fixed effect. Based on Table 4, the probability value is less than 0.05, so it can be concluded that the best method used is the fixed effect. This result implies that there are significant differences among cross-sectional units, in this case, the provinces, and therefore, the unique characteristics of each province must be considered in the model. The Hausmann test examines which method is better between fixed effect and random effect. Based on Table 5, the probability value is less than 0.05, so it can be concluded that the best method used is the fixed effect. This finding strengthens the result of the Chow Test, as it indicates that the random effect model would not provide consistent estimates due to correlation between the explanatory variables and the unobserved individual effects. Because these two tests yield the same results, there is no need to conduct the Lagrange Multiplier Test again. This is reasonable since the Lagrange Multiplier Test is only applied when the comparison between the common effect and random effect models is still relevant. Here are the results of the panel data regression analysis using the fixed effect method, which was chosen because it provides consistent, unbiased, and reliable estimates by taking into account heterogeneity across provinces during the research period.

Table 6. Panel Data Regression Analysis with the Fixed Effect Method

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.345702	0.032338	10.69043	0.0000
X1	-1.18E-05	1.38E-06	-8.537717	0.0000

Variable	Coefficient	Std. Error	t-Statistic	Prob.
X2	7.72E-05	4.93E-06	15.68366	0.0000
X3	-7.98E-06	7.43E-07	-10.74048	0.0000
Cross-section fixed (dummy variables)				
Root MSE	0.053178	R-squared	0.983649	
Mean dependent var	0.380718	Adjusted R-squared	0.980124	
S.D. dependent var	0.416896	S.E. of regression	0.058774	
Akaike info criterion	-2.667604	Sum squared resid	0.576889	
Schwarz criterion	-2.065788	Log likelihood	309.0956	
Hannan-Quinn criter.	-2.424158	F-statistic	279.0702	
Durbin-Watson stat	2.041141	Prob(F-statistic)	0.000000	

Sources: Eviews data processing results (2024)

Based on Table 6, the following regression equation is obtained:

$$Y = -1{,}18X_1 + 7{,}72X_2 - 7{,}98X_3 + 0.345702 \quad (1)$$

The probability results for all variables based on Table 6 show a value of 0.000, which is less than 0.05. This indicates that all independent variables have an effect on the dependent variable in this study.

4.1 The Influence of Balancing Funds on the Level of Regional Independence

Based on Table 6, it shows that the probability value of 0.00 is less than 0.05. This means that balancing funds had an impact on the level of regional independence. Previous research that aligns with the results of this study includes Machfud et al (2020) and Ginting (2019). Balance funds are allocations from the state budget revenue that will later be distributed to all regions in Indonesia. If the balance fund increases, the region will be able to utilize the funds to finance regional needs, thereby becoming a more independent area.

4.2 The Influence of Local Revenue on the Level of Regional Independence

Based on table 6, it shows that the probability value of 0.00 is less than 0.05. This means that local revenue had an impact on the level of regional independence. Previous research that aligns with the findings of this study includes Gaghana et al (2018), Machfud et al (2020), Tolosang (2018), and Wahyuni and Lilis Ardini (2018). If the original regional revenue increases, for example, if local taxes and levies rise, then the region will be able to be more self-sufficient without relying on transfers from the central government.

4.3 The Influence of Economic Growth on the Level of Regional Independence

Based on Table 6, it shows that the probability value of 0.00 is less than 0.05. This means that economic growth had an impact on the level of regional independence. If the economic conditions decline, each region will strive to survive and sustain itself by developing its existing potential, making the region increasingly financially independent. This finding implies that economic growth plays a crucial role as a driver of regional fiscal capacity, since a higher rate of growth generally leads to an increase in local revenue sources. Conversely, during periods of economic slowdown, local governments are often forced to be more innovative and efficient in utilizing their resources, such as optimizing local taxes, re-managing assets, and encouraging community participation. In the long term, these adaptive strategies contribute to strengthening regional independence, as reliance on central government transfers is gradually reduced. Thus, the relationship between economic growth and regional independence is not only statistical but also reflects a dynamic process of local resilience and adaptability.

5. Conclusion and Suggestion

Based on the results of this study, it can be concluded that balancing funds had an impact on the level of regional independence, original regional income affects the level of regional independence, and economic growth also significantly affects the level of regional independence. These findings emphasize the importance of strengthening fiscal capacity and encouraging local economic development in order to reduce dependence on transfers from the central government. The suggestion that the researchers can provide is for future researchers to re-examine the level of regional independence by linking it to other variables that may have an impact, such as investment, government spending efficiency, or levels of innovation within the regions. In addition, the level of regional independence can be studied in its position as either an independent variable or a dependent variable, providing more flexibility in understanding its dynamic role within fiscal and economic frameworks. The extension of the research period also needs to be considered, as longer observations may capture broader economic cycles and structural changes that influence regional fiscal capacity. Furthermore, adjustments to the number of provinces across Indonesia should be made to ensure the results obtained are more accurate, representative, and unbiased, thereby increasing the credibility and generalizability of the research findings.

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