

THE INFLUENCE OF FINANCIAL AUTONOMY, CAPITAL EXPENDITURE, AND UNEMPLOYMENT RATE ON FINANCIAL SUSTAINABILITY IN PROVINCIAL GOVERNMENTS IN INDONESIA

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ABSTRACT This study aims to determine the effects of financial autonomy, capital expenditure, and unemployment rates on financial sustainability in provincial governments in Indonesia. The results of this study are important to provide insights for provincial governments to make appropriate policies for enhancing financial sustainability. The study examines 34 provincial governments in Indonesia, using panel data regression analysis conducted in E-Views version 12. Data were sourced from the audited financial reports of these provincial governments from 2017 to 2022. Financial sustainability is measured using the revenue surplus reported in the operational report. The findings indicate that financial autonomy has no significant effect on financial sustainability, capital expenditure positively impacts financial sustainability, and unemployment has no significant effect on financial sustainability.

Keywords: Financial autonomy, capital expenditure, unemployment rate, financial sustainability, Provincial Government.

INTRODUCTION

In recent years, research has been conducted on financial sustainability in the public sector in response to the financial crisis and austerity policies. International organizations, including the International Public Sector Accounting Standards Board (IPSASB), have highlighted the important role of sustainability in public sector finance. In addition, information on financial sustainability also supports decision-making by public managers and politicians in the delivery of public services (Santis, 2020).

Improving the economic welfare of the community in a sustainable manner is one of the goals of the SDGs (Sustainable Development Goals). This concept is in line with the concept of regional government financial sustainability, namely that regional governments are expected to be able to finance the provision of public services today without reducing their services in the future (RIFAC, 2013; Rodríguez Bolívar et al., 2016). This means that the SDGs and regional governments have a common goal of creating fairness in the provision of public

services between generations. Regional governments, as the entities closest to the community, play a key role in realizing the successful implementation of regional action plans to achieve the SDGs. In line with the goal of SDG number eight, which focuses on decent work and economic growth, the aim is to promote equitable and sustainable economic growth, an optimal and productive workforce, and decent work for all. This goal emphasizes the importance of regional governments in ensuring sustainable and fair public services (https://en.wikipedia.org/wiki/Sustainable_Development_Goals).

The government needs to have healthy finances and adequate fiscal capacity. In the Regulation of the Minister of Finance Number 84 of 2023, fiscal capacity refers to the government's ability to manage revenue, expenditure, and debt efficiently and effectively. With financial sustainability and strong fiscal capacity, the government can maintain the availability of resources needed to provide public services such as education, health, infrastructure, and other social services sustainably for the community. The following Regional Fiscal Capacity (KFD) is a description of regional financial capacity grouped based on the RKFD:

Table 1: Fiscal Capacity Index of Provinces in Indonesia
2021-2023

No	Province Name	2021		2022		2023	
		RKFD	RKFD Category	RKFD	RKFD Category	RKFD	RKFD Category
1	Aceh	0.303	Medium	1.789	Medium	1.049	Very Low
2	North Sumatra	0.893	High	2.019	Medium	2.238	Medium
3	West Sumatra	0.461	Medium	1.411	Very Low	1.460	Low
4	Riau	0.887	High	2.215	High	2.567	High
5	Jambi	0.249	Very Low	1.239	Very Low	1.899	Medium
6	South Sumatra	0.958	High	1.890	Medium	1.832	Medium
7	Bengkulu	0.193	Very Low	1.019	Very Low	1.173	Very Low
8	Lampung	0.526	Medium	1.580	Low	1.726	Low
9	Bangka Belitung Islands	0.196	Very Low	1.506	Low	1.755	Low
10	Riau islands	0.368	Medium	1.621	Low	1.592	Low
11	DKI Jakarta	11.391	Very high	3.007	Very high	3.410	Very high
12	West Java	3.602	Very high	2.546	Very high	2.456	High
13	Central Java	2.046	Very high	1.947	Medium	1.821	Medium
14	D.I.Yogyakarta	0.269	Very Low	1.23	Very Low	1.418	Low
15	East Java	2.541	Very high	1.952	Medium	1.865	Medium
16	Banten	1.133	High	2.934	Very high	2.819	Very high
17	Bali	0.461	Medium	1.761	Medium	2.179	Medium
18	West Nusa Tenggara	0.408	Medium	1.456	Low	1.375	Low
19	East Nusa Tenggara	0.454	Medium	1.47	Low	1.505	Low
20	West Kalimantan	0.508	Medium	1.873	Medium	2.058	Medium
21	Central Kalimantan	0.392	Medium	2.314	High	2.791	High
22	South Kalimantan	0.708	Medium	2.339	High	1.903	Medium
23	East Kalimantan	0.975	High	2.786	Very high	3.652	Very high
24	North Kalimantan	0.294	Medium	1.841	Medium	2.374	High
25	North Sulawesi	0.336	Medium	1.348	Very Low	1.172	Very Low
26	Central Sulawesi	0.278	Medium	1.311	Very Low	1.360	Low

27	South Sulawesi	0.790	Medium	1.511	Low	1.646	Low
28	Southeast Sulawesi	0.233	Very Low	1.284	Very Low	1.517	Low
29	Gorontalo	0.160	Very Low	1.35	Very Low	1.421	Low
30	West Sulawesi	0.179	Very Low	1.548	Low	1.784	Medium
31	Maluku	0.218	Very Low	1.769	Medium	1.496	Low
32	North Maluku	0.274	Very Low	2.633	Very high	2.742	High
33	Papua	0.667	Medium	2.543	Very high	1.935	Medium
34	West Papua	0.651	Medium	3.952	Very high	3.877	Very high
Average		1.000	High	1.912	Medium	1.996	Medium

Source: Peraturan Menteri Keuangan (PMK) No.84/2023

Regulation of the Minister of Finance Number 84 of 2023, which was issued by the government as a means to determine the financial capacity of each region as reflected through regional income and certain regional financing receipts minus income whose use has been determined, certain expenditures, and certain regional financing expenditures. Based on Table 1 provided, it can be seen the IKFD of provincial areas in Indonesia in 2021-2023, where the KFD of provinces in Indonesia is classified into five different categories based on the Fiscal Capacity Index (IKFD). There are thirteen provincial governments that experienced a decrease in IKFD in 2021-2023, which were previously categorized as "High" and "Medium" to the categories "Low" and "Very Low", including the provinces of Aceh, North Sumatra, South Sumatra, Riau Islands, West Java, Central Java, East Java, West Nusa Tenggara, East Nusa Tenggara, South Kalimantan, North Sulawesi, South Sulawesi, and Maluku.

Provincial governments that have a low KFD Index, then most (>50%) of the districts/cities in their region have a low KFD Index, while for provinces that have a high KFD Index, it does not necessarily mean that most districts/cities in their region have a high KFD Index. Low fiscal capacity indicates limitations in local government funding, causing high dependence on central transfers and restrictions on development. Conversely, high fiscal capacity provides financial independence, flexibility, and opportunities to achieve long-term financial sustainability through good debt management and sustainable investment (Herdiyana, 2019).

Based on the Goal Setting Theory approach, setting specific provincial government goals will increase employee motivation to work better. Setting realistic goals in a strategic plan will greatly help local governments achieve financial sustainability in order to provide sustainable services (Navarro-Galera et al., 2016). Therefore, the provincial government needs to set financial sustainability as a target which is then formulated in the budget plan. Local governments create performance targets that they want to achieve from the beginning of budget discussions to the evaluation stage. Financial sustainability in the public sector can be assumed as the goal of the provincial government to provide sustainable services (Rodríguez Bolívar et al., 2018), while the variables of financial autonomy, capital expenditure, and unemployment rate are considered as determining factors for financial sustainability. If these determining factors can be managed properly, financial sustainability as the goal of the provincial government will be achieved.

RESEARCH METHODS

The research method is a quantitative approach. The population of the study was 34 Provincial Governments in Indonesia for 6 years, starting from 2017-2022. So that the total population is 204. The data source is the audited Regional Government Financial Report (LKPD) within the scope of provincial areas in Indonesia from 2017-2022 and data published by the Central Statistics Agency via the link <https://www.bps.go.id>. This study uses 4 variables consisting of dependent variables and independent variables. Regional financial management is considered effective if it is able to represent the ability of the regional government to maintain and renew public service facilities and can maintain its sustainability. According to Rodríguez Bolívar et al. (2016), accrual-based income is considered effective in representing the ability of regional governments to maintain their financial sustainability. The revenue surplus in the budget realization report can be an indicator of FS (Financial Sustainability) in the government sector, so that FS is measured by the following equation:

$$FS = \frac{\text{Surplus Operasional}}{\text{Total population}}$$

According to Bratakusumah and Solihin (2001: 169), to implement real and responsible regional financial autonomy, it is necessary to have the authority and ability to explore own financial sources supported by financial balance between the central and regional governments, as well as between provinces and districts/cities which are prerequisites in the regional government system. The success of regional financial autonomy cannot be separated from the ability of a region in the financial sector. The financial aspect is one of the basic criteria for being able to know in real terms the ability of a region to manage its own household (Ritonga & Mada, 2014). So FA (Financial Autonomy) is measured by the following equation:

$$FA = \frac{\text{Regional Original Income}}{\text{Total Revenue}}$$

Capital expenditure plays an important role because it has a long-term benefit period to provide services to the public (Santis, 2020). The allocation of this capital expenditure is based on the regional needs for facilities and infrastructure, both for the smooth implementation of government duties and for public facilities. Capital expenditure is intended to obtain fixed assets of the Regional Government, namely equipment, buildings, infrastructure, and other fixed assets. The ability of the provincial government to utilize funds significantly to improve public service facilities and infrastructure (Bulan et al., 2023), so that the CE (Capital Expenditure) ratio used is as follows:

$$CE = \frac{\text{Total Capital Expenditure}}{\text{Total Regional Expenditure}}$$

Unemployment is a macroeconomic problem that directly affects human survival. For most people, losing a job is a decline in their standard of living. So it is not surprising that unemployment is a topic that is often discussed in political debates by politicians who often

consider that the policies they offer will help create jobs (Mankiw, 2000). Therefore, the unemployment rate has a negative impact on financial sustainability, although it is necessary to consider whether its effects are general at various levels of government (Subires et al., 2019). According to Wardhani and Payamta (2020), the ability of the provincial government to overcome macroeconomic problems that directly affect the survival of the community, so that UR (Unemployment Rate) can be measured by the following equation:

$$UR = \frac{\text{Unemployment Rate}}{\text{Total Work Force}}$$

The analysis method in this study uses descriptive statistics and panel data regression analysis. Data analysis uses Microsoft Excel program for recapitulation. The next stage is the data is processed and tested using the help of E-Views version 12. Classical Assumption Test (Normality Test, Multicollinearity Test, Heteroscedasticity Test, Autocorrelation Test), Panel Data Regression Analysis, Selection of the best estimation model, hypothesis testing design (Simultaneous significance test (F statistic test), Individual parameter significance test (t statistic test)), and Determination Coefficient.

LITERATURE REVIEWS

Financial Sustainability

Financial sustainability can be defined as the ability of a government to provide services today without compromising its capacity to do so in the future. It is a concept that encompasses three related dimensions: services, revenues, and debt (Rodríguez Bolívar et al., 2018).

Financial Autonomy

In Santis's research (2020), financial autonomy is a form of independence to impose local taxes, collect revenues, and allocate financial resources without external interference. There are various interpretations of the influence of financial autonomy. On the one hand, a high level of independence to impose taxes may help generate revenue to meet citizen demands without damaging the solvency of local governments; on the other hand, politicians may not want to impose too many taxes on citizens because of their strategic vision. So, the results of Santis's research (2020) stated that financial autonomy has a negative effect on financial sustainability. Meanwhile, in Brusca and Cohen (2019), financial autonomy has a positive effect on financial sustainability, which states that financial autonomy has a positive effect on local government revenue surpluses. Navarro-Galera et al. (2016) stated that a region's internal revenue can have a positive effect on financial sustainability. Local governments that provide services whose funds come from Local Revenue, the sustainability of regional finances will be better, because they are not fully dependent on debt or revenue from the central government.

Capital Expenditure

Abdullah and Halim (2006) explained that capital expenditure is closely related to long-term financial plans, especially financing and maintenance of fixed assets as a result of capital expenditure, one type of expenditure related to public services is used to build community facilities. Good financial management is a source of funding for regional spending, especially capital expenditure aimed at improving public service facilities and infrastructure. Improving public services is an indicator of good government performance in terms of accountability to the people. Thus, the decrease in the portion of capital expenditure from year to year will have an impact on the decrease in the quality of the quantity of public services received by the community. Santis (2020) found that capital expenditure has a positive effect on financial sustainability.

Unemployment Rate

According to Sukirno (2006: 87), unemployment can result in a decrease in people's income and harm the level of prosperity that has been achieved. A decrease in the level of prosperity can trigger poverty problems, especially when the workforce grows rapidly, adding to the burden on the economy by creating or expanding jobs. High unemployment rates can reduce tax revenues, increase spending on social support, and cause social instability, all of which affect the financial sustainability of a government entity (Sinervo, 2020). In the study of Rodríguez Bolívar et al. (2016) found that the unemployment rate has a negative effect on financial sustainability which is also in line with the results of the studies by Rodríguez Bolívar et al., (2019) and Cuadrado-Ballesteros and Bisogno (2022). Wise policy management is needed to achieve a positive balance between the unemployment rate and financial sustainability.

RESULTS AND DISCUSSION

Descriptive Statistic Analysis

The average operational report of 34 provincial governments, the highest average value of financial sustainability ratio was obtained by the DKI Jakarta provincial government at 3,712,135 while the lowest was the Bali provincial government at 12,237. The highest average value of financial autonomy was found in the DKI Jakarta provincial government at 0.684, while the lowest was found in the West Papua provincial government at 0.063. The highest average value of capital expenditure was found in the West Papua provincial government at 0.323, while the lowest was found in the Central Java provincial government at 0.080. The lowest average value of unemployment was found in the West Sulawesi provincial government at 0.030, while the highest was found in the Southeast Sulawesi provincial government at 0.193.

Table 2: Chow Test Table

Effects Test	Statistic	d.f	Prob.
		-	
Cross-section F	6,926,058	33,141	0,0000
Cross-section Chi-square	171,512,406	33	0,0000

Table 3: Hausman Test Table

Test Summary	Chiq-sq. Statistic	Chi-Sq. d.f	Prob.
cross-section random	18,551,479	3	0,0003

Selection of Estimation Model

In terms of selecting the best model between the common effect model and the fixed effect model, the researcher used the Chow Test. The Chow Test testing criteria are seen in Table 2, if the Cross-section Chi-square probability value $<$ chi-square testing criteria ($0.000 < 0.050$) so that the selected model is the fixed effect model (FEM). Furthermore, the Hausman Test is carried out to compare the common effect model with the fixed effect model. The testing criteria for the Hausman Test are seen in Table 3 if the Cross-section random probability value $<$ cross-section random testing criteria ($0.0003 < 0.050$) so that the selected model from the Hausman Test is the fixed effect model (FEM).

Classical Assumption Test

Classical assumption testing includes normality test, multicollinearity test, and heteroscedasticity test on 2 equation models. Here are the test results:

Normality Test

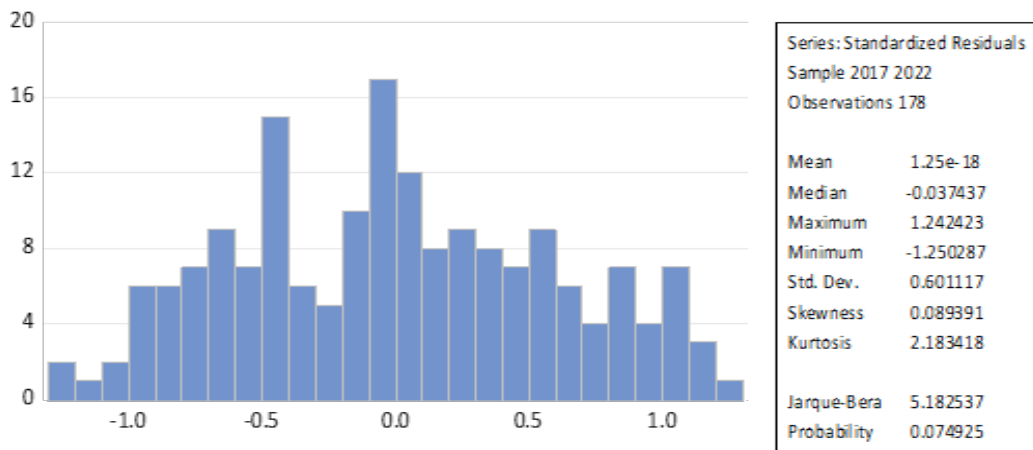


Figure 1: Normality Test

Normality test with histogram graph and Jarque Bera probability. A good regression model is a model with normally distributed residual data. Residual data is normally distributed if the probability value is greater ($>$) than 0.05. Figure 1 shows the results of the normality test after transformation showing a Jarque-Bera Probability value of $0.074925 > 0.05$, meaning that the data used in the study has been normally distributed.

Multicollinearity Test

Table 4: Multicollinearity Test

	FA	CE	UR
FA	0,000000	-0.285463	-0.029350
CE	-0.285463	1.000000	0.010584
UR	-0.029350	0.010584	1.000000

In Table 4, it can be seen that the correlation coefficient of FA and CE is -0.285, FA and UR are -0.029 and the correlation coefficient of CE and UR is 0.010. All correlation coefficients, then it can be concluded that there is no case of multicollinearity, where each predictor has a VIF value < 1.0 .

Heteroscedasticity Test

Table 5: Heteroscedasticity Test

Variable	Significance
C	0.0611
FA	0.9877
CE	0.8677
UR	0.894

In Table 5, the significance of the F statistic prob. of each independent variable is greater than 0.05, namely the FA variable $0.987 > 0.05$, the CE variable $0.867 > 0.05$, and the UR variable $0.894 > 0.05$. then the regression model meets the requirements (homoscedasticity). This means that there is no symptom of heteroscedasticity in the data used.

Autocorrelation Test

Table 6: Autocorrelation Test

Test_Summary	Cross-section_Fixed
Durbin-Watson stat	2.106391
F-Statistic	8.773819
Prob. F-statistic	0.000000
Adjuted R-squared	0.612571

The Durbin-Watson Statistic value is known to be 2.106391. The du value is 1.7891 and the dl value is 1.7206 (can be seen in the Durbin-Watson Table with $\alpha = 0.05$). For the 4-du value is 4-1.7891 of 2.2109 and the 4-dl value is 4-1.7206 of 2.2794. The assumption $du < dw < 4-du$ is met. Where the results of the Autocorrelation test are $1.7887 < 2.106391 < 2.2113$, so it can be concluded that there is no autocorrelation in the regression model.

Test the Hypothesis

Table 7: Panel Data Regression Equation using Fixed Effect

Variabel	Coefficient	Std.Error	t-Statistic	Prob.
C	12.09966	0.188007	64.35871	0.0000
FA	-0.781206	0.359329	-2.174068	0.0314
CE	1.336531	0.563003	2.373932	0.0189
UR	0.375699	0.381784	9.84060	0.3268

Table 7 illustrates the results of the regression equation as follows:

$$KB = 12,09 - 0,78 FA + 1,33 CE + 0,37 UR + e$$

Description:

FS : Financial Sustainability

FA : Financial Autonomy

CE : Capital Expenditure

UR : Unemployment Rate

E : error term

Partial Hypothesis Testing Results (t-Test)

Hypothesis 1 is rejected: The t-Statistic value for the financial autonomy (FA) variable is -2.1740 < t-table 1.9735 and the sig. value is 0.031 < 0.05, then H01 is rejected and Ha1 is rejected. This means that the FA variable does not affect the financial sustainability of provincial governments in Indonesia. Based on the financial autonomy ratio value in Table 7, it is known that all provincial governments in Indonesia have a very low ratio, namely none reaching 1 (one) all are below one. This means that financially, provincial governments in Indonesia have not been able to organize regional autonomy so that they are still very dependent on transfer funds from the central government or loans from other parties. This indicates that the financial sustainability of provincial governments in Indonesia is still very dependent on the central government and other parties. If the provincial government no longer receives income from external parties, the provincial government will not be able to meet all spending and public service expenses. This condition can threaten the financial sustainability of the provincial government for the continuity of public services.

Based on the results of the regression test, it shows that the financial autonomy variable has no effect on financial sustainability in provincial governments in Indonesia. This result is

not parallel with the research of Wardhani and Payamta (2022) which shows that financial autonomy has a positive effect on financial sustainability. This is in line with the research of Brusca et al. (2015) which states that financial autonomy has a positive effect on the surplus of local government revenue. Navarro-Galera et al (2016) states that a region's internal revenue can have a positive effect on financial sustainability.

Hypothesis 2 is accepted: The t-Statistic value for the Capital Expenditure (CE) variable is $2.3739 > t\text{-table } 1.9735$ and the sig. value is $0.018 < 0.05$, then H_02 is accepted and H_{a2} is accepted. This means that the CE variable has a significant effect on financial sustainability in provincial governments in Indonesia. Regional government capital expenditure is a type of expenditure related to public services used to build community facilities (Dollery et al., 2009). Capital Expenditure consists of all expenditures incurred by the city government for the purchase of real estate or infrastructure development and long-term projects. Examples of investments in the capital account can be in the form of real estate acquisitions, purchases of certain assets for economic achievement, use of third-party assets for economic achievement, and acquisition of movable goods, machinery, and scientific technical equipment (Santis, 2020). Therefore, capital expenditure can be said to be an important aspect in financial sustainability, namely as a manager of infrastructure expenditure in the provincial government. The results of the regression test for the capital expenditure variable found that the capital expenditure variable has a significant positive effect on financial sustainability in provincial governments in Indonesia. These results support the results of previous research conducted by Santis, (2020) which stated that capital expenditure has a positive effect on financial sustainability. With good financial management, it can be a source of funding for regional spending, especially capital expenditure aimed at improving public service facilities and infrastructure. However, if capital expenditure management is not appropriate, it can result in excessive financial burdens and pose a risk to financial sustainability, so careful planning and careful risk evaluation are very important (Sholikhah & Wahyudin, 2014).

Hypothesis 3 is rejected: The t-Statistic value for the Unemployment Rate (UR) variable is $0.984 < t\text{-table } 1.9717$ and the sig. value is $0.3268 > 0.05$, so H_03 is rejected and H_{a3} is accepted. This means that the UR variable does not affect the financial sustainability of provincial governments in Indonesia. Based on the results of the panel data regression test, it can be seen that the Unemployment Rate variable does not affect the financial sustainability of provincial governments in Indonesia. The unemployment rate tends to emphasize the negative impact on public spending and financial conditions, the findings in the study indicate that an increase in the unemployment rate can be a threat to financial sustainability and can lead to an increase in net debt. One possible reason behind this is its effect on the formation of current costs, especially financial costs. That is, high unemployment rates can lead to increased public spending to support unemployed citizens, while government revenues from taxes and other sources of income may decrease. Therefore, additional spending on social support and revenue reductions can result in an increase in local government net debt (Rodríguez Bolívar et al., 2016).

Results of Simultaneous Hypothesis Testing (F Test)

Hypothesis 4: The F-statistic value of 16.256 is greater than the F-Table of 2.6565 calculated using the formula (F.INV.RT (probability; deg_freedom1; deg_freedom2)) and the prob.F-statistic value of $0.000 < 0.05$. This indicates that H_04 is rejected and H_{a4} is accepted, which means that financial autonomy, capital expenditure, and unemployment rates jointly affect the financial sustainability of provincial governments in Indonesia. Based on the panel data regression test with a fixed effect model, it was found that financial autonomy, capital expenditure, and unemployment rates jointly affect the financial sustainability of provincial governments in Indonesia. With the Goal Setting Theory approach, provincial governments need to set budget implementation goals to provide public services to the community. This goal is formulated in a strategic plan which is then socialized to stakeholders and provincial government officials so that they understand the goal. With this concept, it is expected to improve the performance of all provincial government officials.

CONCLUSION

Based on the results of panel data testing and the discussion of the research that has been presented previously, this study concludes several things as follows: Financial autonomy does not have a significant effect on the financial sustainability of provincial governments in Indonesia. This means that a high level of financial autonomy does not always guarantee the achievement of good financial sustainability. Capital expenditure has a significant positive effect on the financial sustainability of provincial governments in Indonesia. The higher the capital expenditure, the higher the level of financial sustainability. The unemployment rate does not have a significant effect on the financial sustainability of provincial governments in Indonesia. High or low unemployment rates do not always affect the level of financial sustainability of provincial governments in Indonesia. Financial autonomy, capital expenditure, and unemployment rates together affect financial sustainability in Indonesia.

STUDY LIMITATIONS

Based on the research results, this study still has several limitations as follows: This study has limitations in only testing the population, namely 34 provincial governments in Indonesia. The measurement of the dependent variable of this study uses the adjusted revenue surplus contained in the budget realization report. The data used in this study are secondary data, namely the Regional Government Financial Report (LKPD) for the 2017-2022 period and BPS data. Based on the results and limitations of the study, several suggestions that researchers can provide are as follows: Further research needs to expand the population with samples such as all districts/cities in Indonesia. Further research should consider other proxies that are more related to financial sustainability such as public spending and regional debt. For further researchers, it is necessary to combine primary data as a comparison from the legislature which is also a policy maker within the scope of provincial government in Indonesia.

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