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Analysis of Regional Financial Management Performance Ratios on Economic Growth in the Era of Fiscal Decentralisation in Karanganyar Regency Central Java

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Abstract

Economic growth is a crucial aspect of development, especially in developing countries, as it has a direct impact on people's welfare. Welfare improvement cannot be separated from the role of the government in managing regional finances optimally. Regional financial management that applies the concept of value for money can encourage economic growth, so as to improve people's welfare. This study aims to analyse the effect of regional financial performance on economic growth. The object of this research is Karanganyar Regency using data for the period 2013-2023. The analysis method used is multiple linear regression with the help of SPSS IBM 26 software. The results showed that the regional independence ratio had a positive but insignificant effect on economic growth. Meanwhile, the effectiveness ratio has a negative and significant effect on economic growth. The efficiency ratio is proven to have a positive and significant effect on economic growth. The ratio of the degree of fiscal decentralisation has a negative but insignificant effect on economic growth.

Keywords: *Independence ratio, effectiveness ratio, efficiency ratio, degree of fiscal decentralisation ratio, economic growth*

INTRODUCTION

The 1998 financial crisis in Indonesia changed the government system from centralisation to decentralisation. Decentralisation allows local governments to manage their own territories and manage resources independently, providing more authority for regional development (Hendratno, 2009) . Law No. 32/2004 on Regional Government became the legal basis for this change, establishing the roles and responsibilities of local governments in managing regional autonomy, with the aim of accelerating national economic development and growth. Decentralisation and regional autonomy are important for economic growth as they unlock the potential of various sectors (Saragih, 2003) . Local governments are responsible for managing finances and preparing local revenue and expenditure budgets. The three main aspects of fiscal decentralisation are improving public services, managing local resources efficiently, and encouraging community participation in development. Two key factors in regional autonomy are authorising regions to finance themselves with their own revenue sources and managing budgets in a transparent and accountable manner. Local financial management is also regulated in Law No. 17/2003 on State Finance, where local governments are expected to strengthen own-source revenues as part of the Regional Budget (APBD). Despite improvements, local governments are still dependent on fund transfers from the central government due to resource gaps.

Central Java Province, particularly Karanganyar Regency, has significant economic potential, with agriculture, industry, and tourism driving the economy. Karanganyar is known for its natural beauty and its achievements in financial management, earning an Unqualified Opinion (WTP) for six

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years. However, 70% of its local revenue still relies on central government funds, indicating low own-source revenue. Therefore, more efforts are needed to increase fiscal independence by optimising leading sectors. Karanganyar Regency's financial data from 2013 to 2022 shows an increase in regional expenditure, regional own-source revenue (PAD), and balancing funds. Regional expenditure rose from Rp 1.28 trillion in 2013 to Rp 2.2 trillion in 2022. PAD also grew from Rp 161.7 billion to Rp 511.7 billion. Despite the increase in PAD, the region is still highly dependent on funds from the central government, which accounts for around 70-80% of total regional expenditure. The high dependence on central transfer funds indicates the region's limited fiscal capacity. The potential of the region has not been fully developed, resulting in low PAD. Regional expansion is one of the factors hindering the increase in own-source revenue because resources have not been properly utilised. Financial management performance also faces challenges in budget allocations that often do not reflect priority needs. The Minister of Finance encourages local governments to be more innovative in finding sources of revenue, in accordance with existing regulations (Saragih, 2003) . Continued increases in local spending can lead to fiscal gaps and risk undermining the value for money of financial management. The link between inefficient management and the challenge of achieving value for money can affect the ability of local governments to meet the needs of the community. The central government wants local governments to be more efficient and independent in financial management. Fiscal independence is essential to fund government activities independently. Research shows that financial performance affects economic growth. Some studies found that independence and effectiveness ratios have a positive effect, while efficiency ratios do not. This research encouraged the author to conduct research on "Analysis of Regional Financial Management Performance Ratios on Economic Growth in the Era of Fiscal Decentralisation in Karanganyar Regency, Central Java".

LITERATURE REVIEW

2.1 Agency theory

Agency theory is a concept in economics that addresses the relationship between principals, i.e. owners, and agents, i.e. managers. Introduced by Jensen and Meckling in 1976, this theory shows the potential conflict of interest when the principal entrusts the agent to manage assets. This theory is relevant to analyse local financial management in Indonesia after decentralisation, where local governments act as agents. The central government as the principal authorises the local government. However, differences in interests can lead to budget management that is not in line with the national interest. Strong oversight, accountability and good governance are needed to minimise agency problems. The ratio of independence, effectiveness, efficiency, and degree of decentralisation also affect local financial management.

2.2 Economic growth

Economic growth, or economic growth, is a quantitative measure that compares a country's economic development from year to year. It shows the percentage change in national income from one year to the previous year. Economic growth also reflects an increase in the production of goods and services, which has an impact on people's welfare. The success of a country's economic development can be judged by the economic growth it achieves. According to Robet Solow, economic growth is related to factors such as human resources, capital, technology, and output. Some of the factors that influence a country's economic growth are natural resources, quality and quantity of labour, availability of capital goods, social structure, and market scale.

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2.3 Regional Finance

The definition of regional finance according to Law No. 32 of 2004 article 156 paragraph 1 includes all regional rights and obligations in governance that can be valued in money, as well as regionally owned assets. According to Government Regulation No. 12 of 2019, regional finances also include financial rights and obligations in regional government. The scope of regional finances includes regional rights, regional obligations, regional revenues and expenditures, and assets managed.

2.4 Regional Financial Management

Based on Government Regulation No. 12/2019, regional financial management includes planning, budgeting, implementation, administration, reporting, accountability, and supervision. Local governments must manage finances transparently and efficiently. The regional head plays an important role in this management, which is also regulated by the Budget Law.

2.5 Financial Performance Analysis

1. Independence Ratio

The local financial independence ratio indicates the extent to which a local government can manage its finances without relying on resources from other governments. A high level of independence indicates a low dependence on the central government and a more active part of the community in paying taxes. This contributes to the improvement of people's welfare.

$$Independence\ ratio = \frac{realisation\ of\ local\ revenue}{\text{central government transfers}}$$

2. Effectiveness Ratio

Indicators of local government success in managing finances can be seen from the effectiveness of budget execution. The effectiveness ratio illustrates the government's ability to achieve the target of Local Original Revenue (PAD). A region is considered effective if the ratio is at least 1 (100 per cent). The higher the ratio, the better the financial management. Effectiveness can be analysed by comparing the realisation of local revenue with the specified PAD target.

$$Effectiveness\ ratio = \frac{realisation\ of\ local\ revenue}{\text{local revenue target}}$$

3. Efficiency Ratio

The efficiency ratio is used to measure the efficiency of activities by comparing revenues and expenses. Efficiency means the comparison of outputs and inputs according to performance standards. This ratio shows how well resources are used to generate revenue. The lower the efficiency ratio, the better the financial performance.

$$efficiency\ ratio = \frac{realisation\ of\ regional\ expenditure}{\text{local revenue target}}$$

4. Fiscal Decentralisation Degree Ratio

The degree of fiscal decentralisation ratio measures the ability of a region to finance its expenditure. This ratio is calculated by comparing local revenue to total local revenue. The higher the contribution of local revenue, the more effective decentralisation is implemented.

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$$fiscal\ decentralisation\ degree\ ratio = \frac{realisation\ of\ local\ revenue}{\text{local revenue target}}$$

2.6 Research Hypothesis

1. It is suspected that there is an influence of the independence ratio of regional financial management performance on economic growth in Karanganyar Regency.
2. It is suspected that there is an effect of the effectiveness ratio of regional financial management performance on economic growth in Karanganyar Regency
3. It is suspected that there is an effect of the efficiency ratio of regional financial management performance on economic growth in Karanganyar Regency
4. It is suspected that there is an influence of the ratio of the degree of fiscal decentralisation of regional financial management performance on economic growth in Karanganyar Regency.

METHOD

This study aims to examine the performance of regional financial management on economic growth in Karanganyar Regency during the 2013-2022 period. The focus of this research is on the ratio of independence, efficiency, effectiveness, and degree of fiscal decentralisation. The methodology used is a quantitative approach, with data collection through statistical research methods and instruments. This research took place in Karanganyar Regency. The data collected included financial reports and other information. The analysis was carried out on secondary data in the form of time series data from the APBD and GRDP reports. The analysis method used is multiple linear regression to determine the relationship between economic growth and the variables studied.

RESEARCH RESULTS AND DISCUSSION

a. Normality Test

Table4. 1 Normality Test

Shapiro-Wilk Test		
Independence Ratio	0,301	Normally Distributed
Effectiveness Ratio	0,784	Normally Distributed
Efficiency Ratio	0, 160	Normally Distributed
Fiscal Decentralisation Degree Ratio	0,804	Normally Distributed

Source: Data processed

Based on the table above, the results of the Shapiro-Wilk normality test show the Asymp.Sig. (2-tailed) for each variable that exceeds 0.05 according to the established experimental level. This finding indicates that the data used in the study has a distribution pattern that follows a normal distribution.

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b. Multikolinieritas Test

Table4. 2 Multikolinieritas Test

	Tolerence	VIF
Independence Ratio	0,309	3,232
Effectiveness Ratio	0,505	1,980
Efficiency Ratio	0,693	1,443
Fiscal Decentralisation Degree Ratio	0,246	4,070

Source: Data processed

Referring to Table 4.2, the multicollinearity test results indicate that each independent variable has a VIF value that is still below the 10 threshold. It is known that RK is 3.232, REF is 1.980, REK is 1.443, and RDDF is 4.070. Because all VIF values < 10 and tolerance values > 0.01, it can be concluded that there is no multicollinearity problem in the regression model used in this study.

c. Heteroscedasticity Test

Table4. 3 Glejser Test Results

	Sig
Independence Ratio	0,645
Effectiveness Ratio	0,306
Efficiency Ratio	0,085
Fiscal Decentralisation Degree Ratio	0,514

Source: Data processed

Referring to the Glejser test results listed in Table 4.3, all independent variables show a significance value (Sig.) above 0.05. This means that there is no systematic pattern of relationship between the independent variables and the absolute value of the residuals. These results indicate that the regression model used does not experience heteroscedasticity problems.

d. Autocorrelation Test

Table4. 4 Runs Test Results

Runs Test	
	Unresd
Nilai Sig	1,000

Source: Data processed

Referring to Table 4.4 regarding the test results, the Asymp. Sig. (2-tailed) value of 1.000. This value is used to evaluate whether the residuals in the regression model spread randomly or follow a

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certain pattern. In the run test, if the Asymp. Sig. (2-tailed) is greater than the significance threshold of 0.05, then the residuals are considered non-patterned or random. Since 1.000 exceeds 0.05, it can be concluded that the residuals in this study are random. Therefore, the regression model used does not experience autocorrelation problems, so the assumption of residual independence can be fulfilled.

e. Multiple Linear Regression Test

Table4. 6 Multiple Linier Regression Test

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		B	Std. Error	Beta	T	Sig.	Tolerance	VIF
1	(Constant)	-7.056	2.716		-2.598	.041		
	x1	.070	.061	.180	1.138	.299	.309	3.232
	x2	-.049	.019	-.312	-2.517	.045	.505	1.980
	x3	.181	.018	1.046	9.879	.000	.693	1.443
	x4	-.068	.070	-.173	-.975	.367	.246	4.070

a. Dependent Variable: pdrb

Source: Data processed

1. **The effect of self-reliance ratio on economic growth**

It is known that the significance value of the independence ratio is 0.299 and the t count is 1.138, which indicates that the independence ratio has no effect on economic growth in Karanganyar Regency. This is because Karanganyar Regency still faces challenges in achieving fiscal independence, which is reflected in the high dependence on transfer funds from the central government.
The average transfer funds received from the central and provincial governments reached 70%, while the contribution of Regional Original Revenue (PAD) was only 24.14%. In line with the view of (Tirtosuharto, 2010), the effectiveness of fiscal decentralisation in spurring economic growth can be hampered by the existence of gaps in development capacity and unequal utilisation of resources between regions.

2. **Effect of effectiveness ratio on economic growth**

It is known that the significance value of the effectiveness ratio is 0.045 and t count is -2.517, which indicates that the effectiveness ratio of PAD is significant with economic growth and has a negative relationship direction. This is because inadequate infrastructure can hinder business development and investment, thereby reducing the positive impact of PAD on regional economic growth. In addition to this, local revenue is dominated by local tax revenue as local revenue and is highly dependent on central government transfer funds, so its impact on economic growth is limited. This is because PAD derived from taxes or levies does not always increase investment and production, which can increase economic growth in the long run. With this small difference, an increase in PAD is less able to provide a significant boost to economic growth in the region. Therefore, it is important not only to focus on achieving revenue targets, but also to ensure that public spending is effective in supporting economic growth.

This study supports the findings of (Hasanah, 2024)which suggest that the effectiveness ratio has a negative and significant effect on economic growth in Lampung Province. While these findings

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contradict the results of research by (Nurulita, Arifulsyah and Yefni, 2018), (Syamsudin, Cahya and Dewi, 2015), (Kumpangpune, Saerang and Engka, 2019), and (Fatmawati, 2021) which show that the financial effectiveness ratio has no direct effect on economic growth.

3. Effect of efficiency ratio on economic growth

The study results show that the performance of regional financial management, as measured by the efficiency ratio, has a significant impact on economic growth in Karanganyar Regency. Effective regional financial management allows the government to use its resources more efficiently and can increase the economic productivity of local communities. This is in line with the Harrod-Domar theory which says economic growth is directly proportional (positive) to investment or savings and this research is also in line with agency theory where efficient financial management will increase sustainable development or economic growth.

Thus, regional financial efficiency not only has a positive impact on economic growth in the short term, but also creates a solid foundation for sustainable growth in the future.Conversely, inefficiency in financial management can hinder investment and infrastructure development, which are critical to regional economic growth.Therefore, according to agency theory, transparency and strict supervision mechanisms are needed to ensure that local governments as agents act in the public interest to create a stable, sustainable and inclusive economic environment This research is in line with the findings conducted (Kumpangpune, Saerang and Engka, 2019) which show that the efficiency ratio has a positive effect on economic growth in Bitung City.

4. Effect of the ratio of the degree of fiscal decentralisation on economic growth

The research findings show that the value of the decentralisation ratio as a proxy for regional financial management does not have a significant impact on economic growth in Karanganyar Regency. This condition can be explained by the low level of regional financial independence in Karanganyar Regency, which is indicated by the percentage of the Degree of Fiscal Decentralisation (DDF) which is still relatively low.However, to make an optimal contribution, regional expenditure must be more focused on productive capital expenditure, such as investment in infrastructure, economic sector development, and improving the quality of human resources.Another reason that the impact of fiscal decentralisation on economic growth in Karanganyar Regency is still low is because of the high dependence on transfers from the central government.

Therefore, although the results of this study show that fiscal decentralisation does have a negative impact on the economic growth of Karanganyar Regency, the local government still has opportunities to optimise its fiscal policy to provide more beneficial benefits to the regional economy. In the context of ensuring that fiscal decentralisation is indeed dedicated to development purposes in Karanganyar Regency, the first step is reforming the regional financial management system, increasing fiscal capacity, and more effective APBD planning. The study concluded that fiscal decentralisation has a negative and insignificant impact on economic growth. These findings contradict research (sirajudin al-aksari, 2013) and (Sasana, 2009) which show that fiscal decentralisation has a significant effect on increasing economic growth.

CONCLUSIONS

The independence ratio has no effect on economic growth in Karanganyar Regency and has a positive relationship direction. PAD effectiveness ratio has a negative and significant effect on economic growth in Karanganyar Regency. Efficiency ratio has a significant effect on economic growth in Karanganyar Regency. The ratio of the degree of fiscal decentralisation has no effect on economic growth and has a negative relationship direction.

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