

The Effect of Economic Growth and Regional Expenditure Efficiency on Regional Financial Independence in Central Java Province in 2024

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Abstract

This study aims to analyze the influence of economic growth and regional spending efficiency on regional financial independence in 35 districts/cities in Central Java Province in 2024. Regional financial independence is measured through the contribution of Regional Original Revenue (PAD) to total regional revenue. The research uses a quantitative approach with secondary data sourced from the Central Statistics Agency. The analysis was carried out using multiple linear regression by first meeting the classical assumption test. The results of the study show that simultaneously economic growth and regional spending efficiency have a significant effect on regional financial independence. However, partially, economic growth does not have a significant effect, while the efficiency of regional spending has a positive and significant effect on fiscal independence. These findings indicate that increasing regional financial independence does not only depend on economic growth, but is more determined by the effectiveness and efficiency of regional expenditure management. This research provides important implications for the formulation of regional fiscal policies that are oriented towards improving the quality of public spending.

INTRODUCTION

The implementation of regional autonomy in Indonesia since the fiscal decentralization policy in the early 2000s has brought fundamental changes in governance. Each region is given a larger space to manage development planning and financial management independently. In this framework, regional financial independence is an important aspect because it determines the ability of local governments to finance development without relying excessively on central government transfers. This measure of independence is generally seen through the contribution of Regional Original Revenue (PAD) to total regional revenue.

Regional Original Revenue (PAD) is one of the main indicators in assessing the level of regional financial independence. PAD reflects the ability of local governments to explore and manage local economic potential as a source of development financing without high dependence on the central government. In the framework of fiscal decentralization, increasing PAD is an important prerequisite for the success of regional autonomy because it provides fiscal flexibility for local governments in determining development priorities according to the needs of the local community (Halim, 2014).

Based on data (BPS Central Java Province, 2025) In the publication of Financial Statistics of Provincial and Regency/City Governments throughout Central Java in 2023 and 2024, the realization of PAD in Central Java Province shows an increasing trend. In 2023, the PAD of Central Java Province was recorded at around IDR 18.9 trillion and increased to around IDR 20.1 trillion in 2024 or grew by around 6.3 percent. The increase in PAD is mainly sourced from regional taxes, especially Motor Vehicle Tax (PKB), Motor Vehicle Name Return Duty (BBNKB), and Motor Vehicle Fuel Tax (PBBKB).

Although PAD has increased nominally, its contribution to total regional revenue is still relatively limited. In 2024, Central Java Province's PAD will only contribute around 30–32 percent of total regional revenue, while most of the regional revenue will still be sourced from central government transfer funds, especially the General Allocation Fund (DAU) and the Special Allocation Fund (DAK). This condition shows that the level of regional financial independence in Central Java is still not optimal and fiscal dependence on the central government is still quite high (BPS Central Java Province, 2025) (Mahmudi, 2019).

In addition, there is a significant inequality of PAD between districts/cities in Central Java Province. Areas with a strong economic base, such as Semarang City and several industrial districts in the Pantura area, have relatively high levels of PAD. On the other hand, districts with an economic structure dominated by the agricultural sector and the informal sector tend to have low PAD. This phenomenon indicates that regional economic growth is not always followed by a proportionate increase in PAD if the regional economic structure has not supported the optimization of regional tax and levy collection (Sucipto, 2020; Pratama & Syamsi, 2021).

This condition shows that regional financial independence is not only influenced by economic growth, but also by the effectiveness and efficiency of regional expenditure management. The dominance of employee spending over capital expenditure has the potential to limit the impact of development on the increase in economic activity and regional revenue base. Regional spending that is not directed productively can reduce the multiplier effect of development and weaken the increase in regional fiscal capacity (Barro, 1990; Mardiasmo, 2018).

Previous studies have shown that the relationship between economic growth, spending efficiency, and financial independence is not always consistent. Research by Halim (2014) and Mahmudi (2019) emphasized that strong economic growth can increase the regional tax revenue base if accompanied by strengthening fiscal administration. However, other studies such as Sucipto (2020) and Pratama & Syamsi (2021) found that economic growth does not have a significant effect on fiscal independence, especially in areas where the economic structure is dominated by the informal sector or agricultural commodities with low tax contributions. These findings show that good economic growth is not enough if it is not supported by responsive regional tax policies and an effective PAD management system.

On the other hand, the efficiency of regional spending is often considered to have a more consistent relationship with increasing fiscal capacity. Mardiasmo (2018) and Fitriani (2021) show that spending efficiency, especially through increasing the portion of capital expenditure, can create a multiplier effect on the regional economy and ultimately increase PAD. However, the results of the research of Rosyida (2022) and Utama (2023) actually found that the role of spending efficiency is still weak due to inaccurate allocation and weak budget planning, so that capital expenditure does not always produce a significant economic impact. The difference in the results of this study shows that there is a research gap, namely the lack of a strong conclusion on how economic growth and spending efficiency simultaneously affect regional financial independence, especially in regions that have heterogeneity of economic structures such as Central Java Province.

The research gap is increasingly visible because most of the previous research used data before the pandemic or only focused on a few specific areas, so the latest post-economic recovery context in 2023-2024 has not been studied comprehensively. In addition, there are still few studies that specifically observe the relationship between these two variables in a single analysis model to see the relative contribution of each to fiscal independence. Thus, more up-to-date and data-based

research is needed to provide an empirical picture of the factors that affect regional financial independence at the district/city level.

Based on this phenomenon, research on the influence of economic growth and regional spending efficiency on regional financial independence is relevant to be studied further, especially in Central Java Province which has a heterogeneity of economic structure between regions. This study is expected to be able to provide a more comprehensive empirical picture of the factors that affect regional fiscal independence and become the basis for the formulation of more effective and sustainable regional financial management policies (Fitriani, 2021; Setiawan & Wibowo, 2022).

This study aims to analyze how economic growth and regional spending efficiency affect the level of financial independence in 35 districts/cities of Central Java Province by 2024. This research seeks to contribute novelty by combining the analysis of two main factors of regional fiscal performance in the context of regions that have high variations in economic structure. The results are expected to provide a more comprehensive understanding of the dynamics of regional fiscal independence and become the basis for improving regional fiscal policies in order to strengthen the ability to finance development independently.

METHOD

This research is based on the theory of public finance and fiscal decentralization which places local governments as entities that have the authority to manage regional revenues and expenditures independently. In this framework, regional financial independence is interpreted as the ability of the district/city government to meet development needs through local sources of revenue without great dependence on transfers from the central government. This concept is in line with the view of Oates (1972) in the theory of fiscal decentralization, which emphasizes that the performance of regional autonomy is largely determined by the capacity of local governments to provide public services according to the needs and preferences of local communities.

In regional growth theory, the increase in gross regional domestic product (GDP) is seen as able to expand the tax base and open up opportunities to increase PAD through increased economic activity, business turnover, and added value of productive sectors. However, the literature shows that the influence of economic growth on fiscal independence is not automatic. Growth can only contribute to increasing fiscal capacity if it is followed by effective local tax administration, an economic structure that allows optimal tax collection, and a low dominance of informal sectors that are not cultivated as sources of PAD.

Regional spending efficiency is also an important pillar in regional fiscal theory. The use of the public budget is considered efficient if it is able to produce significant development outputs and support long-term economic capacity building. Barro (1990) and Tanzi and Schuknecht (2000) assert that government spending directed at productive sectors—such as basic infrastructure, public services, and the construction of economic facilities—can trigger sustainable economic growth through the multiplier effect, which in turn expands the regional revenue base. In the Indonesian context, the proportion of capital expenditure is often used as a proxy for expenditure efficiency because it shows the extent to which local governments allocate their budgets to activities that are oriented towards long-term development, rather than just routine spending.

A literature review shows that the relationship between economic growth, spending efficiency, and regional financial independence is not always consistent. Halim (2014) and Mahmudi (2019) stated that strong economic growth can increase PAD if regions have a responsive tax system. However, Sucipto (2020) and Pratama and Syamsi (2021) show different results, where economic

growth does not have a significant effect on fiscal independence, especially in areas with limited economic potential or dominance of the informal sector. Meanwhile, research by Fitrani (2021) and Mardiasmo (2018) confirmed that capital expenditure has a positive effect on regional fiscal capacity, but Rosyida (2022) and Utama (2023) found that an increase in capital expenditure does not always result in an improvement in PAD if it is not accompanied by good planning quality.

Theoretically, regional economic growth and fiscal independence have an interrelated relationship. Sustainable economic growth is expected to be able to expand the regional tax base, increase business activities, and create opportunities to increase PAD. Under these conditions, local governments have a greater fiscal capacity to finance development independently (Musgrave & Musgrave, 1989). However, the relationship between economic growth and fiscal independence is not linear. Various empirical studies show that economic growth does not always have a significant effect on regional fiscal independence, especially in regions with economic structures dominated by the traditional agricultural sector or the informal sector (Pratama & Syamsi, 2021; Sucipto, 2020). This shows that economic growth needs to be supported by effective regional fiscal policies so that it can be converted into an increase in PAD.

Thus, economic growth is an important factor, but not the only determinant of regional fiscal independence. Fiscal independence is more determined by the ability of local governments to manage economic growth through regional tax policies, the effectiveness of PAD collection, and accountable and efficient regional financial governance (Halim, 2014; Mardiasmo, 2018).

In addition to national research, various studies conducted by Pekalongan University lecturers also make important empirical contributions related to regional finance topics. Syafnita (2021) in the *Journal of Economics and Business* found that regional fiscal independence is greatly influenced by the effectiveness of PAD collection and regional spending structures, especially in regions with a growing tax base. Prasistiasari research (2023) shows that fiscal interventions during the pandemic, such as direct assistance and public spending adjustments, have implications for the financial ability of villages and regions to maintain fiscal independence. Meanwhile, a study by Setiawan and Wibowo (2022) from the Faculty of Economics, University of Pekalongan shows that capital expenditure and the quality of budget governance have a significant role in increasing the fiscal capacity of district/city governments in Central Java. The three studies reinforce the finding that the effectiveness of spending and revenue administration remain more dominant factors than economic growth in influencing fiscal independence.

Based on the theoretical foundation and literature review, this study uses a quantitative approach to analyze the correlation between economic growth, spending efficiency, and regional financial independence. The research population covers all 35 districts/cities in Central Java Province and all of them are used as samples (census method). The data used is secondary data that is fully obtained from the Central Statistics Agency (BPS), including PAD data, total regional revenue, capital expenditure, regional spending, and ADHK Gross Regional Domestic Product in 2024. The data collection method is carried out through documentation techniques by examining official statistical publications published by BPS. Data analysis was conducted using correlation techniques to see how strong the relationship between economic growth, spending efficiency, and regional financial independence was, with classical assumption tests conducted beforehand to ensure the data met the requirements of statistical analysis. This approach is expected to provide an objective empirical picture of the relationship between variables and be the basis for the formulation of policies to increase regional fiscal capacity in Central Java.

The hypotheses proposed in this study are:

H1: Economic growth has a positive effect on regional financial independence in Central Java Province

H2: Regional Expenditure Efficiency Has a Positive Effect on Regional Financial Independence in Central Java Province

H3: Economic growth and regional spending efficiency simultaneously have a significant effect on regional financial independence

RESULTS AND DISCUSSION

Normality Test Results

The normality test was carried out using the *Kolmogorov Smirnov* test as seen in table 1. The results of the normality test showed a significance value of 0.200; this value exceeds the significant limit of 0.05; Which means the residual data is normally distributed and meets important assumptions in regression analysis. This residual normality ensures that the model used does not deviate from the normal distribution, so that the results of the regression coefficient estimation can be trusted for statistical decision-making.

**Table 1. Normality Test Results
One-Sample Kolmogorov-Smirnov Test**

		Standardized Residual	
N		35	
Normal Parameters ^{a,b}	Mean	.0000000	
	Std. Deviation	.97014250	
Most Extreme Differences	Absolute	.087	
	Positive	.087	
	Negative	-.079	
Test Statistic		.087	
Asymp. Sig. (2-tailed) ^c		.200 ^d	
Monte Carlo Sig. (2-tailed) ^e	Sig.	.716	
	99% Confidence Interval	Lower Bound	.705
		Upper Bound	.728

a. Test distribution is Normal.

b. Calculated from data.

c. Lilliefors Significance Correction.

d. This is a lower bound of the true significance.

e. Lilliefors' method based on 10000 Monte Carlo samples with starting seed 926214481.

Multicollinearity Test Results

Based on the results of the multicollinearity test, it was carried out by looking at the value of the *Variance Inflation Factor (VIF)* as seen in table 2. The results of the multicollinearity test showed that the *VIF* value was 1.001 (the value was less than 10.00) for both variables, namely economic growth and regional spending efficiency. This very low *VIF* value indicates the absence of a strong linear correlation between independent variables, so that each variable can be analyzed simultaneously without affecting the stability of the model. This is important because it allows for

a more accurate interpretation of the results regarding the combined influence of the two factors on regional financial independence.

Table 2. Multicollinearity Test Results

Coefficients ^a			
		Collinearity Statistics	
Model		Tolerance	VIF
1	SQRT_X1	.999	1.001
	SQRT_X2	.999	1.001

a. Dependent Variable: SQRT_Y

Partial Test Results (Test – t)

Based on Table 3, the results of the partial test show that the economic growth variable (X1) has a regression coefficient value of 0.953 with a significance value of 0.165, which is greater than 0.05. This indicates that partial economic growth does not have a significant effect on regional financial independence. Thus, the H1 hypothesis is rejected. These findings show that increasing regional economic growth does not necessarily directly increase regional financial independence.

Table 3. Test Result - t and Test - F

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.001	2	4.001	7.789	.002 ^b
	Residual	16.437	32	.514		
	Total	24.438	34			

a. Dependent Variable: SQRT_Y

b. Predictors: (Constant), SQRT_X2, SQRT_X1

Coefficients ^a					
		Unstandardized Coefficients		Standardized Coefficients	
Model		B	Std. Error	Beta	t
1	(Constant)	-.759	1.742		-.436
	SQRT_X1	.953	.671	.206	1.421
	SQRT_X2	.975	.261	.541	3.730

a. Dependent Variable: SQRT_Y

These results can be explained through public finance theory which states that economic growth does not automatically increase regional revenue. Musgrave and Musgrave (1989) emphasized that only economic growth that occurs in sectors that are the object of regional taxes can increase Regional Original Revenue (PAD). If economic growth is dominated by the informal sector or sectors with taxation authority at the central level, then the impact on regional fiscal independence will be relatively limited (Sucipto, 2020).

These findings are consistent with the results of previous research which showed that economic growth does not have a significant effect on regional fiscal independence. Research by

Pratama and Syamsi (2021) found that in many regions, economic growth does not directly increase PAD due to the limited regional tax base and weak policies to intensify and extensify PAD. Thus, economic growth that is not accompanied by strengthening fiscal administration tends to produce a weak impact on regional financial independence.

Meanwhile, the regional expenditure efficiency variable (X2) showed a regression coefficient value of 0.975 with a significance value of < 0.001 , which means it is smaller than 0.05. This shows that the efficiency of regional spending has a positive and significant effect on regional financial independence. Thus, the H2 hypothesis is accepted. The standardized beta coefficient value of 0.541 shows that regional spending efficiency has a more dominant influence than economic growth in increasing regional financial independence. These findings indicate that efficiently and productively allocated regional spending, especially capital spending, is able to have a more tangible impact on increasing regional fiscal capacity.

Theoretically, these findings support the theory of public expenditure efficiency put forward by Barro (1990) and Tanzi and Schuknecht (2000), which states that productively allocated government spending, especially capital expenditure, is able to create a multiplier effect on the regional economy and expand the regional revenue base. Efficient spending not only improves the quality of infrastructure and public services, but also encourages sustainable economic activity so that it has an impact on increasing PAD. The results of this study are also in line with various previous empirical studies. Mardiasmo (2018) and Fitrani (2021) found that regional spending efficiency has a more consistent and significant influence on increasing fiscal independence than economic growth. Research by Setiawan and Wibowo (2022) on districts/cities in Central Java also shows that capital expenditure and the quality of budget management play an important role in strengthening regional fiscal capacity.

Simultaneous Test Results (Test – F)

The results of the regression model ANOVA test can be seen in table 3, showing an F value of 7.789 with a significance level of 0.002. These findings indicate that simultaneously, the variables of economic growth and regional spending efficiency contribute significantly to the variation in regional financial independence in Central Java Province. In other words, the two variables together affect the ability of regions to increase the ratio of Regional Original Revenue (PAD) to total regional revenue, which is the main indicator of fiscal independence. These results show that the regression model used in the study has met the feasibility of the model (*goodness of fit*), so that the independent variables together are able to explain the variation in regional financial independence. Thus, the H3 hypothesis which states that economic growth and regional spending efficiency simultaneously have a significant effect on regional financial independence is acceptable.

These results support the theory of fiscal decentralization put forward by Oates (1972), which states that the effectiveness of decentralization is highly dependent on the capacity of local governments to manage financial resources independently. Healthy regional economic growth is expected to expand the economic base and tax objects, while regional spending efficiency is key in ensuring that the available budget is allocated appropriately and productively, so as to be able to produce a sustainable effect in increasing PAD.

The relevant literature also confirms the importance of these two variables. For example, Barro (1990) and Tanzi & Schuknecht (2000) explain that effective public spending, especially capital spending, can create a multiplier effect that increases regional fiscal capacity in the long run. Empirical studies by Fitrani (2021) and Mardiasmo (2018) in the Indonesian context confirm that the efficiency of regional spending through productive budget allocation is a key factor in strengthening regional financial independence. Research from lecturers from Pekalongan University also confirmed that the factors of spending efficiency and fiscal administration capacity greatly affect the ability of regions to increase PAD.

However, the heterogeneity of economic conditions between districts/cities in Central Java Province is an important factor that affects the dynamics of this relationship. In some areas with a relatively limited economic base or a high level of economic informality, economic growth

does not necessarily directly increase fiscal independence. This is in line with the findings of Pratama & Syamsi (2021) and Sucipto (2020), who stated that without strong tax administration and responsive fiscal policies, economic growth alone is not enough to drive a significant increase in PAD.

The main novelty of this study is the use of the latest data in 2024 which explicitly tests the simultaneous influence of economic growth and regional spending efficiency on fiscal independence in all districts/cities of Central Java Province. This research strengthens the argument that the success of increasing regional fiscal independence is not only determined by economic growth, but also by how local governments are able to manage and use the budget efficiently and productively.

In the context of policy, these findings confirm that local governments need to strengthen spending governance, especially capital expenditure, with careful planning and transparent and accountable implementation. Targeted investment in infrastructure and public services can drive broader and sustainable economic activity, while increasing the region's original revenue capacity. Thus, focusing on improving spending efficiency will make a significant contribution to reducing dependence on central transfers and strengthening regional financial independence.

Overall, the results of this study provide relevant and recent empirical contributions in the field of regional finance, especially related to the interaction between economic growth, spending efficiency, and fiscal independence in Central Java Province. This research also opens up opportunities for follow-up studies that can integrate other variables such as fiscal administration capacity, budget management transparency, and local economic structural factors, in order to gain a more comprehensive understanding of the dynamics of regional fiscal independence.

CONCLUSION

This research shows that economic growth and regional spending efficiency together play an important role in determining the level of regional financial independence in Central Java Province. However, regional spending efficiency has a more dominant role than economic growth in increasing the ability of regions to finance development from local sources of income. These findings affirm the importance of productive and effective budget management as the main key to increasing regional fiscal independence.

Theoretically, the results of the study strengthen the framework of fiscal decentralization by emphasizing that not only economic expansion is needed, but also the efficiency of the use of budgetary resources. Practically, this study implies that local governments need to focus on increasing the capacity of planning and managing capital expenditure in order to be able to encourage sustainable economic growth and strengthen the original income base of the region.

Overall, this study concludes that increasing regional financial independence in Central Java Province is not enough to rely only on economic growth, but is highly dependent on the ability of local governments to manage spending efficiently and productively. Therefore, the policy implication of this study is the need for local governments to focus more on strengthening fiscal independence strategies on improving the quality of regional expenditure planning and management, especially capital expenditure, in order to create sustainable development and reduce dependence on transfers from the central government (Halim, 2014; Mardiasmo, 2018).

In the future, this research can be developed by including other variables such as the quality of tax administration, transparency of financial management, and local economic structural factors to gain a deeper understanding of the dynamics of regional fiscal independence.

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