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The Influence of Local Government Financial Performance on Public Welfare in Banten, Indonesia

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Abstract

The purpose of this research is to investigate how public wellbeing in Banten Province is impacted by local governments' financial performance between 2010 and 2023. Public welfare as shown by the Human Development Index (HDI), unemployment rate, and poverty rate is significantly impacted by the financial performance as determined by the regional independence ratio, fiscal decentralization ratio, and regional dependency ratio. Public wellbeing is also significantly impacted by the spending alignment ratio as a moderator variable. Public welfare is not significantly impacted by the relationship between the expenditure harmony ratio and local government financial performance.

Keywords

Human Development Index (HDI), local government financial performance, poverty rate, public welfare, unemployment rate.

INTRODUCTION

The central government assigns the responsibility to local governments, enabling them to independently oversee and manage their financial affairs. Local governments are recognized as the most informed entities concerning the unique conditions, requirements, and possibilities of each region. So that local governments can maximize their revenue from local taxes and local retribution.

Well-managed regional finances will affect regional progress [1]. The evaluation of regional financial capability is demonstrated by regional financial performance, assessed via local government financial ratios. Local governments must rigorously assess their financial performance to ensure that the managed budget adequately meets community needs and aligns with defined objectives, thereby facilitating the attainment of community welfare. The central government consistently highlights local financial independence as a crucial element of the financial performance of local governments. The central government encourages local governments to explore regional potential that will generate local own revenue (PAD), so that in the end local governments can slowly release their dependence on central government transfer funds.

However, on the other hand, this fiscal decentralization causes problems, because not all regions have sufficient local revenue sources to develop their regions. The municipal government's financial performance is seen to be inefficient. There are significant differences in local governments' financial performance across jurisdictions. The wellbeing levels of a region's people may be used to gauge its financial success. Local governments that have poor financial performance such as Pandeglang Regency and Lebak Regency have low HDI values and high unemployment and poverty rates. On the other hand, local governments with good financial performance such as South Tangerang City, Tangerang City and Tangerang Regency have the largest HDI in Banten Province and low unemployment and poverty rates.

This study analyses variations in welfare levels across eight domains: Population, Health and Nutrition, Education, Employment, Consumption Levels and Patterns, Housing and Environment, Poverty, and Other Social Factors. These areas function as standards in the endeavor to enhance quality of life. [2]. For example, in terms of population, the population increases every year, which of course creates its own problems for Banten Province. This is because in the process of planning and determining development policies, there will be more and more things that need to be considered. Moreover, the increasing population will risk increasing the number of poor people, as a result the poverty rate will continue to increase. Poverty constitutes a critical challenge, impeding the underprivilege’s access to education, healthcare, and other essential services. It is essential for local governments to adopt effective solutions and policies to tackle this challenge [3], Research findings indicate a significant relationship between financial performance and the poverty rate. Research indicates that financial performance does not affect poverty alleviation in the regions [4]. A contributing factor is the ability of the district or city government to leverage the economic potential of its region.

Efforts to improve community welfare are financed by several sources of funds, both from the center, between regions, and local revenues managed by the local government. The financial performance of local government pertains to a region's ability to identify and effectively utilize its financial resources. This capability is crucial for meeting obligations, delivering community services, and promoting regional development. The local government is permitted to function autonomously from the central government, while retaining the capacity to allocate resources in a manner that serves the local community, all in accordance with

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established laws and regulations. Local financial independence denotes the ability of local government to finance its operations, development initiatives, and community services through the taxes and levies it collects, serving as the principal source of regional revenue. The region's financial independence is shown by the ratio of local revenue to income from other sources, such as loans and help from the federal government. A number of measures, such as the independence ratio, dependency ratio, harmony ratio, and fiscal decentralization ratio, may be used to assess regional financial capabilities.

The financial performance of local governments focuses on the achievement of local revenue. If the local revenue of a regency/city is large, it means that the economic activity of the region is also high, which means that there are many jobs for entrepreneurs or investors who build their businesses in the area. This is also followed by high purchasing power of the community which makes the economic wheel turn quickly, thus generating large local revenue potential. Therefore, it is hoped that public welfare can be achieved.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Underpinning Theory

This research is primarily guided by agency theory, as articulated by Jensen and Meckling in their 1976 publication. Agency theory posits that the relationship between the populace and the government can be defined as an agency relationship. This relationship arises from a contract formed by citizens, who act as the principal, engaging the government, which serves as the agent, to provide services that reflect the interests of the citizens. To monitor government actions and align the objectives of the populace with those of the government, it is crucial for citizens to hold the government accountable for the management of entrusted resources. A regular financial reporting system can facilitate this outcome. The principal, facing a lack of insight into the agent's actions because of information asymmetry, necessitates an intermediary to verify the accuracy of the agent's reports. The financial reports, supervised by the government, allow the public, through the legislature, to assess, analyze, and monitor the government's performance regarding its initiatives to improve citizen welfare. As principals and agents, of course, in their implementation they must be transparent and clear, so that undesirable things such as corruption do not occur in the implementation process.

Local Government Financial Performance

The financial performance of the regional government pertains to its ability to analyze and manage regional financial resources efficiently, thereby ensuring the fulfilment of its obligations in maintaining the governmental framework, providing public services, and promoting regional development. Financial performance involves a degree of autonomy from the central government, facilitating enhanced flexibility in fund allocation to benefit the regional community [5] [6].

As stated in the Regional Revenue and Expenditure Budget (APBD), the regional government's ability to oversee regional finances is a measure of its ability to provide social services, community development initiatives, and governmental operations. Additionally, a thorough financial ratio analysis of the authorized and executed budget is necessary to assess the regional government's financial capabilities. The evaluation of local financial performance involves analyzing the level of autonomy, the efficacy and efficiency of regional budgeting, the congruence of expenditures, and the degree of budget absorption. [7].

Public Welfare

To preserve and improve social and economic stability, the welfare system is crucial. In order to reduce the prevalence of social jealousy in society, this condition is essential. The well-being of an individual is characterized by various measurable indicators of achievement. Welfare denotes a condition defined by health, comfort, and happiness resulting from the consumption of goods and services [8]. Social welfare includes various programs and services aimed at helping individuals meet their basic social, economic, educational, and health needs, which are crucial for societal well-being [9].

The United Nations Development Program (UNDP) characterizes human development as a framework aimed at expanding individual choices, accomplished through initiatives that empower the populace. Development programs can achieve this by focusing on the improvement of essential human capabilities. This encompasses enhancing health standards, fostering longevity and healthy lifestyles, ensuring individuals acquire the necessary knowledge and skills for productive economic participation, and guaranteeing adequate income that affords decent purchasing power.

This research assesses community welfare by examining three distinct variables: the Human Development Index (HDI), the unemployment rate, and the poverty rate.

Empirical Overview and Hypothesis Development

Research related to the financial performance of local governments related to economic growth and public welfare has many connections. Among others, [10] who observed in South Sulawesi in 2009-2014, found that the performance of regional autonomy was proven to be able to increase the Human Development Index in the following year and reduce poverty rates in the next two and three years, but did not correlate with unemployment. Similar research was also conducted by [11] This research examined how financial performance directly affects poverty, economic growth, capital spending, and the Human Development Index. From 2018 to 2021, the research focused on Banten Province and investigated the indirect relationship between poverty and regional financial performance, as mediated by capital expenditure, economic growth, and the Human Development Index. The results indicated that poverty was influenced by financial performance as measured by the independence, effectiveness, fiscal decentralization, and reliance ratios; however, this relationship was not statistically significant. The human development index was impacted by the financial performance as measured by the independence, effectiveness, fiscal decentralization, and dependency ratios; however, the impact was not statistically significant. The independence ratio, effectiveness ratio, fiscal decentralization ratio, and dependency ratio with regard to economic growth all showed that capital spending had a major impact on financial performance. This significantly impacts the human development index.

The concept of expenditure harmony pertains to the strategic prioritization by local governments in the allocation of funds between regional employee expenses and public service investments in an optimal manner (Halim, 2007). The alignment of expenditures indicates the financial performance of regions, thereby enhancing overall welfare. An increased allocation of funds for regional employee expenditures suggests a probable decrease in the proportion of investment spending, particularly in public services focused on enhancing community economic infrastructure.

Based on previous research, the following hypotheses can be articulated:

H1: Financial performance (measured based on the regional financial independence ratio, fiscal decentralization ratio, and dependency ratio) has a significant effect on public welfare (measured based on the Human Development Index, unemployment and poverty rate).

H2: Expenditure harmony has a significant effect on public welfare.

H3: Expenditure harmony as a moderator variable strengthens the relationship between financial performance and public welfare.

RESEARCH METHODS

Sample and Data

The sample in this study was all regencies/cities in Banten Province consisting of 4 regencies and 4 cities that will be observed for 14 years, namely from 2010 to 2023. The data collected were samples of financial reports including budget realization reports for 2010–2023 that had been audited by the Republic of Indonesia Audit Board (BPK). The data was obtained from the DJPK website, administered by the Ministry of Finance at djpk.kemenkeu.go.id. Data pertaining to the Human Development Index, unemployment, and poverty from 2010 to 2023 was obtained from the Statistics Indonesia (BPS) website for Banten Province (banten.bps.go.id).

Variable Measurement

This research evaluated the financial performance of local governments through an analysis of the local independence ratio, fiscal decentralization ratio, and dependency ratio. This study incorporates the expenditure harmony ratio as a moderating variable to strengthen the relationship between financial performance and community welfare.

The regional financial independence ratio demonstrates the capacity of the Regional Government to finance its activities, development projects, and community services through the utilization of taxes and levies as primary income sources.

The examination of PAD concerning total revenue demonstrates the level of autonomy present within a region. An elevated ratio of PAD to total income reflects a higher degree of autonomy for a region, indicating that its expenditures are increasingly financed by local revenue sources. Thus, the local independence ratio can be formulated as follows:

$$Local\ Independence\ Ratio = \frac{Realization\ of\ Local\ Own\ Revenue}{Realization\ of\ Transfer\ Revenue}\ x\ 100\%$$

Fiscal decentralization entails the delegation of financial management authority from the central government to regional entities. This process enables local governments to develop policies and allocate expenditures, ensuring that all responsibilities formerly managed by the central government are now independently handled at the local level, with the ultimate goal of improving population welfare [12]. The formula for calculating the Fiscal Decentralization Ratio, as detailed in reference [13], is provided below:

$$Fiscal\ Decentralization\ Ratio = \frac{Realization\ of\ Local\ Own\ Revenue}{Realization\ of\ Total\ Revenue}\ x\ 100\%$$

The dependency ratio represents the share of a local government budget (APBD) that is financed by transfer revenues from the central government and other local governments. A higher ratio signifies a more negative assessment of the financial performance of the regional government. The dependency ratio is measured by comparing transfer revenues with total regional revenues, which is described by the following formula:

$$Dependency\ Ratio = \frac{Realization\ of\ Transfer\ Revenue}{Realization\ of\ Total\ Revenue}\ x\ 100\%$$

The expenditure harmony ratio demonstrates how local governments strategically allocate funds between regional employee costs and public service expenditures effectively. An increased allocation of funds for regional employee expenditures suggests a probable decrease in the share of investment spending dedicated to public services that support the development of community economic infrastructure. The alignment ratio is defined as follows:

$$Harmony\ Ratio = \frac{Realization\ of\ Total\ Expenditure - Employee\ Expenditure}{Realization\ of\ Total\ Expenditure}\ x\ 100\%$$

This research evaluates public welfare using three distinct indicators: the Human Development Index (HDI), unemployment rate, and poverty rate.

The Human Development Index (HDI) assesses three primary indicators: per capita income, life expectancy, and educational attainment.

The unemployment rate is calculated based on the percentage of the Open Unemployment Rate (TPT) as reported in the BPS survey.

Poverty is evaluated based on the number of individuals living below the poverty line, as defined by Statistics Indonesia (BPS), with an emphasis on the ability to meet basic needs. The poverty rate is taken from the percentage of poor people according to the BPS survey.

RESULT AND DISCUSSION

This model evaluates three separate hypotheses. The financial performance, assessed via the local independence ratio, fiscal decentralization ratio, and dependency ratio, influences public welfare, which is evaluated using indicators such as the Human Development Index (HDI), unemployment rates, and poverty levels. The relationship between financial performance and public welfare is characterized by a structural coefficient of -0.574, accompanied by a P value of 0.003, which is below the 0.05 threshold. This indicates a significant and negative relationship between financial performance and public welfare. A higher local independence ratio, fiscal decentralization ratio, and dependency ratio indicate improved financial performance, the lower the unemployment rate and poverty rate which are indicators of public welfare, while the HDI indicator does not have much influence because it is very difficult, and it takes years to increase the HDI value.

Second, the structural coefficient for the influence of the ratio of expenditure harmony on public welfare is -0.255 and the p-value is 0.007. These results indicate that the influence of expenditure harmony on public welfare is significant, which means that spending on the public reduces unemployment and poverty rates.

The ratio of expenditure harmony functions as a moderating variable in the relationship between financial performance and public welfare. The moderator coefficient is 0.093, accompanied by a P value of 0.211, exceeding the threshold of 0.05. The results demonstrate that spending alignment does not significantly influence the relationship between financial performance—assessed through the regional financial independence ratio, fiscal decentralization ratio, and dependency ratio—and the improvement of public welfare, which encompasses advancements in HDI along with decreases in unemployment and poverty.

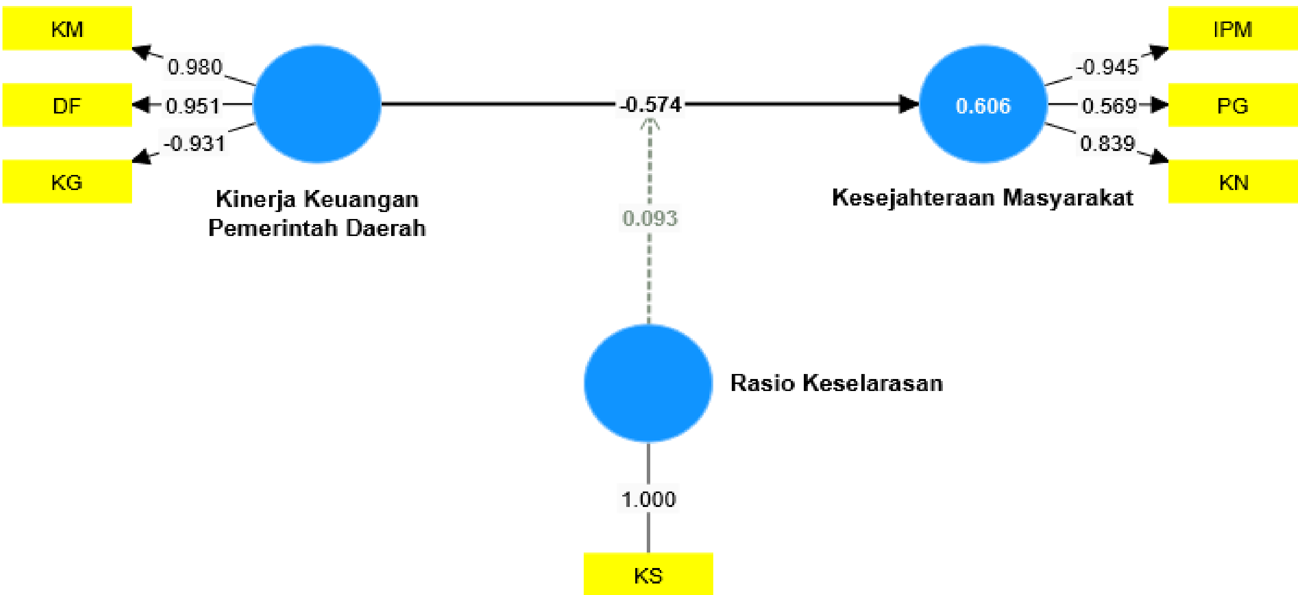

Figure 1. Model result output from SmartPLS

The significant level of local financial independence and fiscal decentralization affects the decrease in unemployment and poverty rates and contributes to the increase in the Human Development Index, though to a limited degree. Enhancing the HDI requires substantial effort across various sectors and is a lengthy process. The initiatives implemented focus on the health sector, with the objective of improving life expectancy and providing adequate health services. The education sector aims to increase the average duration of schooling, serving as an indicator of the region's success in attaining formal education free from external pressures. This is anticipated to positively impact the community's economy, as individuals acquire greater education and knowledge, resulting in an enhanced standard of living and increased purchasing power for the population. The dependency ratio significantly impacts individual welfare; a lower ratio suggests a more advantageous condition. This enables individuals to manage their finances with reduced dependence on transfers from the central government or other local authorities.

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CONCLUSION AND RECOMMENDATION

Based on the results of data testing, it can be concluded that the financial performance of local governments has a significant negative effect on public welfare, which means that the better the financial performance of local governments, the lower the unemployment rate and poverty rate, but it does not have a significant effect on the Human Development Index (HDI). Then, the expenditure harmony ratio also has a significant negative effect on public welfare, which means that expenditure spent on the public reduces unemployment and poverty rates. Lastly, the effect of spending alignment as a moderator variable in the relationship between financial performance (local financial independence ratio, fiscal decentralization ratio and dependency ratio) with increasing public welfare (increasing HDI and decreasing unemployment and poverty) is not significant.

Seeing these results, local governments must pay more attention to improving public welfare through their financial performance. Local governments need to allocate local government budget (APBD) to sectors that will support public welfare, especially the sectors studied in this study. In addition, increasing local own revenue is also needed so that local governments can more freely develop their regions and improve the welfare of their people.

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