The Effect of Local Own Revenue and General Allocation Funds on Capital Expenditures in East Java, Indonesia

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Abstract - *Capital expenditure is an important indicator in development in Indonesia. The amount of capital spending shows the realization of the seriousness of local governments in infrastructure development, tourism and trade to increase economic growth. In this research, the researcher will look at the extent of the influence of local revenue and general allocation funds on capital expenditure in the province of East Java. Using panel data between 2015 and 2019 in 38 districts and cities in East Java, will be analyzed with the Least Square Panel (PLS). As a result, local revenue has a significant positive effect and general allocation funds have a significant negative effect on capital spending in East Java.*

***Key Words*: Local Own Revenue, General Allocation Funds, Capital Expenditure**

1. INTRODUCTION

The paradigm of regional financial management has experienced significant dynamics since the implementation of regional autonomy in 2001. The regional financial management system which is carried out independently is oriented towards the public interest and carries the goal of community welfare. Regional financial management takes the form of all activities which include planning, implementation, reporting, accountability and supervision of regional finances, which are important aspects of regional financial management. The implementation of this regional financial management is carried out with an integrated, structured system and is based on the regulations set forth in the Regional Budget (APBD) annually (Praza, 2016). Regional financial management as outlined in the regional budget annually must be oriented to the public interest, formulated with a performance approach, have a relationship with regional policy makers in making policies, and seek to link the APBD, regional financial management systems and procedures (Ulfa, 2013).

The majority of regional financial management is carried out by using an output-oriented financial performance approach, the concept of value for money and the application of the principles of good governance (Korompot and Warongan, 2017). Government performance can be viewed from its performance in determining the portion of the budget prepared according to the needs and potential of the region. This is expected to be able to provide improved services to the community. A very important component of regional finance includes spending and income. Shopping is an important component to meet people's needs so that they can achieve prosperity. The same applies to the income component, which is the place to organize and manage income from the potential of an area.

Regional expenditure is an important component of regional financial budget structure consisting of capital expenditure, personnel expenditure, goods and services expenditure and several other expenditures included in the budget component. The Minister of Home Affairs Regulation Number 13 of 2006 states that capital expenditure is part of the regional expenditure group in the form of expenditure in the context of investing in tangible fixed assets of benefit value that can be used in government activities. One of the most important components of spending is capital spending because it has an important influence on the economic growth of a region and will have many contributions to lift regional economic movements (Kuncoro 2004 and Praza, 2016). So that local governments need to provide a large portion according to regional needs in increasing development and accelerating the ratio of economic movement through greater capital spending.

Several empirical studies show the findings that capital expenditure on local governments is influenced by regional financial performance, especially the dependency ratio, independence, effectiveness of PAD (Regional Original Income). An empirical study of Prihastuti, et al (2015) found that financial performance will directly impact capital spending. Meanwhile, from the empirical study of Nani and Vitor (2012), it is found that a country's expenditure and income are related to one another. Capital is one of the most important components of government spending in obtaining a large portion to help drive economic movement (Amuka, et al. 2016). This capital expenditure includes financing and investment in infrastructure, public debt capital and capital transfers for regional governments and decentralized government institutions (Bojanic, 2013). From the study of Hayode, et al (2015) found that capital expenditure has a positive effect on economic growth. In this regard, the government tries to increase capital expenditures for public purposes to encourage economic growth (Venkatarama and Urmi, 2017).

To minimize the budget deficit, it is necessary to reduce the size of large expenditures to be diverted to capital and investment expenditures (Nwosu and Okafor, 2014). Direct expenditure which is set forth in the form of capital expenditure can contribute to the quality of public services as well as increase regional revenue sources. The smaller portion of capital expenditure is not able to contribute to economic growth. Allocation of capital expenditure is carried out with a fairly good financial balance so that the increase in public services expected by the community can be achieved (Abu and Abdullahi, 2010). Therefore, the government must control spending more effectively, especially to prioritize infrastructure allocations. The allocation of regional expenditures which emphasizes more on capital expenditures will have an impact on increasing economic growth and increasing the standard of living of local communities (Patricia and Izuchukwun, 2013; Indiyati and Rahyuda, 2018).

The government's efforts to create prosperity and increase economic growth through regional financial allocations through capital expenditures are also influenced by regional financial performance (Arsa and Setiawina, 2015). Some of the regional financial performance can be viewed from the ratio of local government financial performance. This measurement of local government financial performance can also be used as an assessment of the government's accountability and capacity from the financial side in carrying out regional autonomy. Financial performance is a form of achievement that local governments have from the realization of regional financial management, both in terms of revenue and expenditure. Good financial performance can affect the proportion of appropriate capital expenditures for public services (Riswan and Affandi, 2014). So that changes in financial performance can indirectly have an impact on changes in the proportion of capital expenditures of a region (Prihastuti, et al. 2015).

This component reflects the condition of the autonomy of a region as measured by the ratio between PAD and the total amount of regional revenue that comes from central, provincial government assistance and loans (Halim, 2008). The results of a study conducted by Jatitmas, (2015) found a significant positive influence between the ratio of financial independence to capital expenditure. In addition, various empirical debates also occur on the role of Regional Original Revenue and General Allocation Funds in influencing capital spending. Lestari et al, (2016) found that the variables of Local Own Revenue and General Allocation Funds showed a significant positive effect on capital expenditure and local financial independence. This paper will focus on discussing the effect of Local Own Revenue and General Allocation Funds on capital expenditure in East Java, Indonesia.

2.LITERATURE REVIEW

Regional autonomy seen as one of the significant changes resulting from public sector reform. Law Number 22 of 1999 concerning Regional Government (later revised by Law No. 32 of 2004 and subsequently revised back to Law No. 23 of 2014) regulates regional autonomy which gives local governments much greater authority to manage their own regions with minimal assistance from the central government. Thus, local governments have discretion to use their financial resources to determine the allocation of resources for regional expenditures; by adhering to the principles of compliance, local needs and capabilities as well as the aspirations of the community as stated in the regional government budget (Chariri, Diponegoro, Jatmiko, Prabowo, & Diponegoro, 2019; Kuntari, Diponegoro, et al., 2019).

Article 1 of Law 23/2014 states that Regional Expenditures are all Regional obligations that are recognized as a deduction for net assets in the period of the fiscal year concerned. Furthermore, it is explained in Article 298 that Regional Expenditures are prioritized to fund Mandatory Government Affairs related to Basic Services which are determined with minimum service standards and are guided by the analysis of regional spending standards and unit price standards in accordance with the provisions of laws and regulations.

Provision of state financial resources for local governments in the context of implementing decentralization is based on the handover of tasks by the central government to regional governments by taking into account fiscal stability and balance. Balanced funds are the embodiment of the concept of transfer of funds from the central government to local governments in Indonesia. The balancing fund consists of the General Allocation Fund (DAU), the Special Allocation Fund (DAK) and the Profit Sharing Fund (DBH). The Regional Revenue and Expenditure Budget (APBD) is a reflection of the activities of the regional government and the allocation of resources it uses. Local governments will select priority activities and allocate funds for these activities. The selected activities imply local government policies in considering community welfare.

The Regional Revenue and Expenditure Budget (APBD) is the annual financial plan of the regional government which is discussed and approved by the Assembly in the Regions and is determined by regional regulations. APBD is the basis of local financial management which is a guide for local governments in providing services to the public in one fiscal year. The capital expenditure budget describes local government policies in regional development. Local budgets are plans for local government activities and resource allocation. Regional budget allocation indicates local government policies in development financing. The public sector budget is an activity plan, which is manifested in the form of a plan to increase income and allocate expenditure in monetary units (Gomes, Alfinito, & Albuquerque, 2013; Jacobs, 2009).

The concept of capital spending is related to the theory of fiscal decentralization. Fiscal decentralization is defined as the expenditure and revenue allocation mechanism in an intergovernmental financial system that ensures efficient delivery of public services (Tiebout, 1961; Tirto suharto, 2017; Yushkov, 2016), while the level of fiscal decentralization, which is usually used to measure the level of decentralization, is defined as a share of subnational expenditure / income compared to total government expenditure / income (Badrudin, 2011; Kee, 2004; Oates, 1993). Based on the premise of allocative efficiency, fiscal decentralization has the potential to support efficiency in the local economy and also encourage competition between governments (Bird & Wallich, 1993; Davoodi & Zou, 1998). This implies that local governments must optimize the use of limited fiscal resources to meet community welfare. Excessive expenditures or mismatches in expenditure assignments can damage economic growth and regional development (Davoodi & Zou, 1998; Devarajan, Swaroop, & Zou, 1996)

In addition there is also a link between federalism theory and capital expenditure, namely the limited income earned by each. -Each region makes the responsibilities carried out by the region not maximal, so that there is transfer funds from the central government as one of the sources of regional revenue both in the form of general transfer funds and special transfer funds. With the transfer funds provided by the central government, the responsibility that can be carried out by local governments will be greater because the financial capacity of local governments is greater (Kappeler & Välilä, 2008). Therefore, development planning and development implementation that can be carried out by the government will be greater. This reflects that with the transfer funds from the central government, the capital expenditure that can be allocated by local governments will be greater.

3.RESEARCH METHODS

This research is *explanatory research,* which is a quantitative study in testing the hypothesis on an influence or relationship between variables. This study uses panel data. Panel data is combined data from data *time series* and *cross section*. The data *time series* used in this study were from 2015 to 2019, meanwhile, the data *cross section* used in this study were 38 districts and cities in East Java. The specification of the research model used in this study modifies the research conducted by Indiyanti & Rahyuda, (2018); Pangestu et al., (2018) and Praza, (2016).

$$Y_{it} = \alpha + \beta_1 X_{1\,it} + \beta_2 X_{2\,it} + \varepsilon_{it\,This}$$

equation explains that capital expenditure (Y) is influenced by local revenue (X1), general allocation funds (X2). The method used in this research is *the Least Square Panel* (PLS).

4.RESULTS AND DISCUSSION

The coefficient of determination (R2) measures how far the model's ability to explain the variation in the dependent variable. The coefficient of determination is between 0 and 1. A small R^2 value means that the ability of the independent variables to explain the variation in the dependent variable is very limited. A value close to one means that the independent variables provide almost all the information needed to predict the variation in the dependent variable.

Table 4.1. Results the Coefficient of Determination (R2)

Model	R-Square	Adjusted R Square	Std. Error of regression
Fixed Effect Model (FEM)	0.937	0.917	0.379

Value on the Adjusted R Square (R2) shows 0.917 or 91% which means that the independent variable can simultaneously explain the dependent variable by 91%. Meanwhile, the remaining 9% can be explained by variables outside the model. Thus, the model used in this study shows a good model. The results of the *Fixed Effect Model* (FEM) will be explained in the following table.

Table 4.2. Results Analysis of *Fixed Effect Model* (FEM)

Variable	Coefficient	Std. Error	t-statistic	Probability
Constant	34.00	29 547	1150	0251
PAD	1815	0227	7975	0000 *
DAU	-2051	1119	-1833	0068***

* α = 1%, ** α = 5%, *** α = 10%

Based on the analysis results *Fixed Effect Model* (FEM) can be written as the following linear regression equation:

Y = 34.00 + 1,815X1 - 2,051X2 + e

a. Effect of PAD to the Capital Expenditure

Based on statistical test results in Table 4.10 shows that The significance value of PAD is 0.000 which is smaller than the value (α) 0.01. These results explain that PAD has a significant positive effect on the amount of capital expenditure in East Java. Thus, based on the results of the hypothesis test, it shows that H1 is accepted and H0 is rejected. The results of this study are in line with the results of previous empirical studies from Juniawan and Suryanti (2018), Lestari et al, (2016) and Solikin and Widyawaty (2009) which concluded that PAD has a significant effect on capital spending. Thus the results of this study contradict previous empirical studies by Suryantini et al (2017), Badrudin and Kuncorojati (2017) and Syam et al (2018) which state that PAD has no significant effect on capital spending. Hypothesis test results also show that the effect of PAD is positive and significant with a coefficient value of 1.118830 which explains that when there is an increase in PAD it will have an effect on the increase in the amount of realized capital expenditure.

Based on the results of data analysis, the PAD relationship has a significant effect on capital expenditure, thus indicating that the higher the PAD, the higher the government expenditure for capital expenditure, and vice versa if the region has lower PAD, the regional government capital expenditure is also low. The results of this study are in line with Law no. 58 of 2005 concerning regional financial management which states that PAD is prepared in accordance with the needs of governance and regional revenue capabilities. This means that in every APBD preparation, if the local government is to allocate capital expenditures it must be fully adjusted to regional needs by taking into account the PAD received. Between PAD and capital expenditure there is a reciprocal relationship in local government finances (Chariri et al., 2019; Pirade, 2018). This condition is in accordance with the objectives of the fiscal decentralization theory that supports local governments to be more competent in regional development that has been mandated by the central government. Regional revenue is the ability of local governments to provide funds as a source of regional management within a certain period (Badrudin, 2011; Chariri et al., 2019). Therefore, the government must encourage the optimization of sources that encourage increased regional income. The increase in regional revenue is expected to reduce the proportion of transfer income from the central government to regional governments. Apart from that, the role of revenue transfer in the form of profit sharing cannot be excluded because the role of the regions affects the amount of profit sharing.

b. The Effect of General Allocation Funds (DAU) on Capital Expenditure

The results of statistical tests show that the DAU partially has an influence on the realization of capital expenditures as evidenced by a significance value of 0.0685 which is less than (α) 0.10. Based on these results, H2 is accepted and H0 is rejected, so it can be concluded that DAU has a significant effect on capital expenditure realization in East Java. The results of this study are in line with previous empirical studies by

Solikin and Widyawaty (2009), Marpaung et al. (2017), Asnawi and Ulan (2018) who state that DAU has a significant effect on capital expenditure. Thus the results of this study contradict previous empirical studies by Sari and Wirama (2018), Kusuma (2016) and Jati et al, (2019) which explain that DAU has no significant effect on capital spending. The results of statistical tests also show that DAU has a negative effect on expenditure realization as indicated by the coefficient value of -2.050785. Based on the coefficient value, it can be concluded that when the general allocation fund increases, the realization of capital expenditure has decreased.

The results indicate that the DAU, which is a general transfer from the Central Government to Regional Governments to address horizontal inequalities with the main objective of equal distribution of financial capacity between regions, has not been maximally realized. The research findings indicate that DAU affects capital expenditure negatively and significantly. DAU has a function to reduce the gap between Regions and Cities throughout Indonesia. The results that show both DAU and capital expenditure are still negative, implying that the higher the DAU transfer from the central government, the lower the fiscal gap, so that the contribution to capital spending is also lower. A lower DAU implies a higher fiscal gap, thus contributing to a higher contribution to capital spending (Armawaddin & Ahmad, 2019; Fahlevi, 2017; Suryantin et al., 2018). The results of this study indicate that the objectives of decentralization governance to allocate general allocation funds have been optimized and there is no significant dependence of local governments on the central government. Therefore, each region in the vicinity can increase the general allocation fund by increasing the balance fund and utilizing the general allocation fund which is intended to help finance activities in the region. The regional activities referred to are regional affairs and in accordance with national priorities, in particular to finance basic facilities and the achievement of basic public services, certain standards to encourage the acceleration of regional development. General allocation funds are allocated based on the concept of a fiscal gap (Armawaddin & Ahmad, 2019; Fahlevi, 2017; Nuarisa, 2013; Suryantin et al., 2018; Tuasikal, 2008).

5.CONCLUSION

From the analysis that has been done, it can be concluded that local revenue has a positive effect on capital expenditure in East Java. This can be explained that the higher the income of a region, the higher the budget allocation for regional development, which makes the region more advanced. Meanwhile, the general allocation funds provided by the central government to the regions had a significant negative relationship. This explains that the districts in East Java are no longer dependent on the central government. So that the treatment of general allocation funds can be allocated based on the concept of the fiscal gap of each region.

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