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How Does Regional Income Affect Regional Spending?

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ABSTRACT

This research aims to know the influence of regional income to regional spending. Areas of the research around Indonesia`s provinces. The research ensures significantly in its potential to shed light on how regional governments can effectively manage their budgets to foster economic growth and development. The analysis used is multiple linear analysis with the help of the STATA 14 application. The data used is data on Regional Spending, Regional Original Income, Transfers to Regions, and Village Funds, and Other Income for 2020-2022 in Indonesia's provinces taken from the Ministry of Finance Republic of Indonesia. The findings of the study reveal a noteworthy impact of Regional Original Income and Transfers to Regions, and Village Funds on Regional Spending. Nevertheless, the research outcomes also indicate the absence of a significant effect between Other Income and Regional Spending. The importance of Original Regional Income, Transfers to Regions, and Village Funds in making decisions regarding the allocation and use of the budget for Regional Spending. The implication of this research is that regional governments can consider increasing Regional Original Income and managing Funds Transferred to Villages and Regions effectively to support better Regional Spending.

Keywords: Funds Transferred to Villages and Regions, Other Income, Regional Income, Regional Original Income, Regional Spending

INTRODUCTION

Regional development is prepared and implemented by the region by utilizing existing resources. Regional development plays as an integral role in national development (Samiun, 2022). Rapid regional development requires large allocations of development funds, causing regional government spending to increase. The amount of regional income in question determines the amount of regional spending. Regional government agencies that receive spending budgets must, of course, be able to support the growth of regional spending to improve the well-being of the people of each city/district in Indonesia (Kainde, 2013).

Decentralization policies can realize efficient and effective resource management to achieve and create regional autonomy. The realization of regional autonomy and financial decentralization is based on the idea that regional governments better understand their regions' potential, events, and problems. Regional governments will better understand the budget needed for government and development activities. The implications of regional autonomy reform and decentralization of fiscal authority, namely transferring authority and resources from the central government to regional governments (Hutchinson, 2017). One of the objectives of implementing fiscal decentralization is to reduce the fiscal gap between the central government and regional governments (vertical fiscal imbalance) and between regions (horizontal fiscal imbalance) (Boex & Martinez-Vazquez, 2006; Wang, 2014). According to Fisher in Kuncoro (2003), intergovernmental transfers are a frequent occurrence. worldwide as a form of financial relationship between central and regional governments. In Indonesia's fiscal decentralization, regional government revenue sources to fund government operations and development include local original income (PAD), transfers from the central government, and other legal revenues (Law Number 33 of 2004).

The independence of a region in the financial sector can be seen from how much local original income contributes to regional income. Regional income is all regional government rights recognized as adding to the value of net assets (Mangowal, 2013). An increase in PAD is constantly sought in implementing autonomy because PAD is revenue originating from the region to finance regional government administration and is used as a benchmark in implementing regional autonomy. The various investments implemented by the government are expected to provide positive results, which are reflected in an increase in Original Regional Income (PAD) (M. Rahmawati & Fajar, 2017). Each region in Indonesia has a different PAD, which will result in differences between revenue and spending—this difference in potential results in inequality between regions. Based on data obtained, Regency/city regional governments in Indonesia show that the proportion of PAD can only finance regional government spending at a maximum of 20 percent (Ansori & Muthmainah, 2019). A problem that often arises is the low ability of local governments to produce accurate predictions of regional income so that it cannot be collected optimally.

This research contributes to the development of a study conducted by (Mangowal, 2013) and (Rahmawati & Fajar, 2017), which took different research locations, namely regional governments throughout Indonesia. Apart from that, the variables in this research also adjust to the conditions of the research area, namely regional income and spending in all regions in Indonesia.

LITERATURE REVIEW

Regional Spending

Regional spending, according to Law Number 32 of 2004, is defined as all regional liabilities recognized as a drop in net assets in the relevant fiscal year period. Regional revenue, balancing funds, and regional loans are the key sources of regional finance in the implementation of fiscal decentralization (Mahendra, 2018). Regional spending refers to regional government spending used to fund regional development efforts (Rahmawati & Fajar, 2017). Local governments must effectively control these spending. Personnel expenses, for example, might stymie progress and economic growth (Račkauskas & Liesionis, 2013). Regional governments might perform evaluations to define spending priorities that must be implemented and altered to meet the demands of the region (Simanjuntak & Mukhlis, 2013).

Regional Income

In accordance with Law No. 32 of 2004’s general rules, regional income is defined as all rights recognized as an addition to net assets within the applicable fiscal year term. On the other hand, income in the context of the relevant fiscal year period is defined by Halim and Abdullah (2006) as all regional revenues in the form of increased assets or decreased debt from diverse sources. Regional original income, transfers to regions and village finances, and other permissible sources of income are the sources of regional income. Village grants and transfers to regions are examples of regional funding obtained from the APBN.

Regional Original Income

Regional original income, often known as PAD, is money generated by the region's activities. Regional income serves to support economic activity as well as many types of regional spending (Simanjuntak & Mukhlis, 2013). Furthermore, Olusola (2011) said that high regional revenue reflects the effective functioning of regional autonomy. Rinaldi (2014) also highlighted that the APBD’s large share of initial regional income suggests that regional governments have reduced their reliance on the central government. As a result, the area may be termed self-sufficient in managing its regional revenue (Yuliandari, Chaidir, & Mahmudi, 2017). Regional spending will rise if regional original income rises as well. This will have an effect on boosting spending in order to improve societal wellbeing (Adriani & Yasa, 2015).

Transfers to Regions and Village Funds

One of the government’s responsibilities in serving the community is to provide equal public services. Intergovernmental transfers from the center to the regions are one method of providing fair public services. Intergovernmental transfers are an integral component of the relationship between the central and regional administration (Murniasih & Mulyadi, 2011). This financing strategy is adopted as part of Indonesia’s fiscal decentralization framework to address fiscal imbalances. Fiscal imbalances can develop between central and regional governments as well as between regional governments themselves (horizontal fiscal imbalances). To decrease budgetary imbalances, it is necessary to adopt central government transfers.

Other Income

Other regional revenue is defined in Regional Government Law Number 23 of 2014 as all regional income other than original regional income and transfer income. Other revenue comprises grants, emergency funding, and income derived from legislative provisions.

Hypothesis Development

Funds from the central government have an essential role in supporting the smooth process of decentralization from the center to the regions, considering the imbalance between spending and income at the regional level (Digdowiseiso & Afriyanto, 2023). Therefore, it is necessary to transfer fiscal or fiscal management from the center to the regions as a solution. Fiscal transfers can be realized in various forms, such as subsidies, grants, and special grants, significantly increasing local government revenues.

Regional original income is income that regional governments constantly obtain by maximizing all potential financial resources to finance their duties and responsibilities. Purwantoro and Setyowati (2019) and Rahmawati and Suryono (2015) stated in their research that local original income influences regional spending. Regional original income plays a role in determining the region's ability to carry out government activities and programs. So, the hypothesis of this research is:

H_1: Regional Original Income has a positive effect on regional spending.
H_3: Other income has a positive effect on regional spending.

Good regional government financial management cannot be separated from government administration. Funds obtained by the regions are used to finance government administration, development, community empowerment, and community development, with priority to finance regional development (Lestari, 2020). Providing fair public services based on tax revenues obtained by regions is the reason for transfers to regions and village funds (Digdowiseiso & Afriyanto, 2023). Transfers to regions and village funds are a form of the government's role in creating stabilization. Each region's different needs and capabilities give rise to an obligation for the central government to carry out equal distribution, especially concerning regional spending. Hence, funds transferred to villages and regions are essential for regional governments. Thus, the hypothesis of this research is:

H_2: Funds Transferred to Villages and Regions have a positive effect on regional spending.

RESEARCH METHOD

The data used in this research is derived from APBD reports at the provincial level in Indonesia. The information regarding Provincial APBDs in Indonesia was obtained from the website of the Directorate General of Fiscal Balance of the Ministry of Finance (https://djpk.kemenkeu.go.id/portal/data/apbd). This research focuses on the provincial government (34 provinces) in Indonesia during the period of 2020-2022.

In this research, a panel data regression analysis is used as the analytical approach with the Stata 14 tool. In order to determine the impact of the independent variable on the dependent variable, it is necessary to conduct multiple stages of testing. In order to determine the superior model among the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM), it is imperative to conduct Chow, Hausman, and Lagrange Multiplier tests. The subsequent set of tests comprised classical assumptions, namely autocorrelation, heteroscedasticity, and multicollinearity tests. In the meantime, the outcomes derived from panel data regression analysis can make use of various model types such as CEM, FEM, and REM. The influence of the independent variable on the dependent variable can be observed from the F-stat prob value, as indicated by the chosen model. The T-stat prob value allows us to observe the impact of each variable.

There is 1 dependent variable and 3 independent variables used in this research. the dependent variable is regional spending while the independent variable is Regional Original Income, Transfers to Regions and Village Funds, and Other Income. This is variable operationalization of the research as described below:

Table 1. Description of Variable Operationalization

Variable	Explanation	Measurement
Dependent Variable		
Regional Spending (BD)	Regional spending refers to the allocation of resources for the implementation of regional government activities. It is obligatory for the region and is accounted for as a reduction in net assets within the annual budget (Abdullah & Junita, 2016).	Regional Spending in this research is quantified through the accumulation of all regional expenses from each province for the 2020-2022 (Aswar & Surbakti, 2013).
Independent Variable		
Regional Original Income (PAD)	Regional Original Income refers to the income acquired through the various activities conducted within a particular region (Simanjuntak & Mukhlis, 2013).	Original Regional Income in this research is quantified through the accumulation of all original regional income from each province for 2020-2022.
Transfers to Regions and Village Funds (TKDD)	Intergovernmental transfers are an inseparable part between the central and regional governments (Murniasih & Mulyadi, 2011).	Transfers to Regions and Village Funds in this research are quantified through the accumulation of all Funds Transferred to Villages and Regions (TKDD) from each province for 2020-2022.
Other Income (PL)	Other income encompasses grants, emergency funds, and additional income provided through legal regulations (UU No. 23 of 2014).	Other income in this research is quantified through the accumulation of all other income from each province for 2019-2022.

RESULTS

Descriptive Statistics

Descriptive statistical analysis is utilized in this study to give a thorough summary of the data, which includes the independent research variables and the dependent variable (regional spending). The independent factors considered are additional sources of revenue, regional original income, and fiscal decentralization (in the form of transfers to regions and village finances).

Table 2. Descriptive Analysis Results

Variable	Obs	Mean	Std. Dev.	Min	Max
Regional Spending (BD)	102	33388.63	30110.35	7619.61	130637.2
Transfers to Regions and Village Funds (TKDD)	102	22194.33	17191.37	5632.67	78032.21
Regional Original Income (PAD)	102	8637.148	12158.6	807.73	54866.45
Other Income (PL)	102	2628.762	3280.681	173.75	17220.81

Note: Processed from Stata 14 results.

Regional spending (BD) levels in 34 provinces range from a low of 7619.61 to a high of 130637.2 during the 2020-2022 period. During this period, the average regional spending value for these provinces is 33388.63, with a standard deviation of 30110.35. Because the standard deviation is less than the average, the variation in regional spending (BD) data among provinces for 2020 - 2022 is likely to be minor.

Table 2 shows that funds transferred to villages and regions (TKDD) in the same 34 provinces range from 5632.67 to 78032.21 for the 2020 - 2022 timeframe. The average value of funds transferred to villages and regions (TKDD) throughout these provinces for 2020-2022 is 22,194.33, with a standard deviation of 17,191.37. Similar to regional spending, the lower standard deviation compared to the average indicates that variation in transfers to regions and village funds (TKDD) statistics among provinces for the 2020-2022 period is minor.

When it comes to Original Regional Income (PAD) in the same group of provinces for the 2020-2022 period, numbers range from 807.73 to 54866.45. The average Original Regional Income (PAD) value for these provinces for this time period is 8637.148, with a standard deviation of 12158.6. The higher standard deviation relative to the average in this scenario suggests that the variation in Regional Original Income (PAD) statistics among provinces for 2020 - 2022 tends to be substantial.

Finally, the value of Other Income (PL) in the 34 provinces ranges from 173.75 to 17220.81 for the 2020-2022 period. For 2020-2022, the average Other Income (PL) value across these provinces is 2628.762, with a standard deviation of 3280.681. Similar to Original Regional Income, the higher standard deviation compared to the average indicates that variation in Other Income (PL) data across provinces for 2020 - 2022 is likely.

Hypothesis Test

Simultaneous Significance Testing

Simultaneous testing is employed to examine hypotheses concerning the collective impact of independent variables on the dependent variable. According to the test criteria, if the probability result from the statistical F test is below the significance level of alpha 0.05, it indicates that the independent variables collectively influence the dependent variable.

Table 3. Simultaneous Hypothesis Test Results

Model	Statistic	Prob.
Model 1	8851.04	0.0001

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Simultaneous testing of the effects of Regional Original Income (PAD), Fiscal Decentralization (TKDD), and Other Income (PL) on Regional Spending (BD) yields a F statistical value of 8851.04 with a probability of 0.0001. The test results indicate a probability level of significance (=5% or 0.05). This means that Regional Original Income (PAD), Fiscal Decentralization (TKDD), and Other Income (PL) all have a significant concurrent influence on regional spending (BD).

Partial Significance Testing
Partial testing is used to determine whether the independent variable has a partial influence on the dependent variable. According to the test criteria, if the probability value is at the level of significance (=5% or 0.05), there is a partial influence of the independent variable on the dependent variable. Partial significance testing is explained as follows:

Table 4. Hypothesis Test Results

Variabel	Coef.	Std. Err.	t	P > |t|
Regional Original Income (PAD)	0.9375353	0.0329476	28.46	0.001
Transfers to Regions and Village Funds (TKDD)	0.9995526	0.0342214	29.21	0.001
Other Income (PL)	1.092145	0.3414678	3.20	0.085
_cons	235.6127	039.82979	5.92	0.027

The Effect of Regional Original Income (PAD) on Regional Spending Hypothesis Testing
The effect of Regional Revenue (PAD) on Regional Expenditures (BD) yields a t value of 28.46 and a probability of 0.001. There is a significant impact of Regional Original Income (PAD) on Regional Expenditures (BD) as indicated by the probability value, which is less than the significance level (=5%. The resulting coefficient value is 0.9375353 (positive), which means that if Regional Original Income (PAD) rises by a unit, Regional Expenditures (BD) will rise by 0.9375353 units, assuming all other variables remain constant. Thus, hypothesis 1, "Regional Original Income has a positive effect on regional spending", is accepted.

The Effect of Transfers to Regions and Village Funds (TKDD) on Regional Expenditures: Hypothesis Testing
When the effect of Transfers to Regions and Village Funds (TKDD) is tested on Regional Expenditures (BD), the t value is 29.21 and the probability is 0.001. This probability value is at the level of significance (= 5% or 0.05), indicating that Funds Transferred to Villages and Regions (TKDD) have a significant influence on Regional Expenditures (BD). The resulting coefficient value is 0.9995526 (positive), which means that if Funds Transferred to Villages and Regions (TKDD) increase by a unit, Regional Expenditures (BD) will increase by 0.9995526 units, assuming all other variables remain constant. Thus, hypothesis 2, "Transfers to Regions and Village Funds have a positive effect on regional spending", is accepted.

The Effect of Other Income (PL) on Regional Expenditures Hypothesis Testing
Upon examining the impact of Other Income (PL) on Regional Expenditures (BD), a probability of 0.085 and a t value of 3.20 are obtained. The likelihood value is greater than the significance level (α=5%), suggesting that Other Income (PL) has no discernible impact on Regional Expenditures (BD). Consequently, the third hypothesis, which claims that "Other income has a positive effect on regional spending", is disproved.

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DISCUSSION

The results of this research state that local original income has a positive effect on regional spending. Central government funds have an essential role in supporting the smooth process of decentralization from the center to the regions, considering the imbalance between spending and income at the regional level (Digdowiseiso & Afriyanto, 2023). Regional original income is income that regional governments constantly obtain by maximizing all potential financial resources to finance their duties and responsibilities. This study is consistent with previous studies by (Purwantoro & Setyowati, 2019) and (Rahmawati & Suryono, 2015) which state that original regional income influences regional spending. Regional original income plays a role in determining the region's ability to carry out government activities and programs. Regional governments can increase regional revenues, where the results of the management of these resources will be included in local original income revenues which will later be allocated as a source of funding for regional government spending in addition to other sources of income (Fatimah, Nopiyanti, & Mintoyuwono, 2019).

Good regional government financial management cannot be separated from government administration. Funds obtained by the regions are used to finance government administration, development, community empowerment, and community development, with priority to finance regional development (Lestari, 2020). Providing fair public services based on tax revenues obtained by regions is the reason Funds Transferred to Villages and Regions (Digdowiseiso & Afriyanto, 2023). Funds Transferred to Villages and Regions are a form of the government's role in creating stabilization. Each region's different needs and capabilities give rise to an obligation for the central government to carry out equal distribution, especially concerning regional spending. Hence Funds Transferred to Villages and Regions are essential for regional governments.

The third hypothesis, that other income has a positive effect on regional spending, is rejected. This study contradicts the findings of Asari and Suardana (2018), who claim that other income influences regional spending. The findings of this study are consistent with those of Susilowati, Sitinjak, and Juwari (2021). Susilowati, Sitinjak, and Juwari (2021), in her research, stated that other income has the lowest nominal value compared to original regional income and transfers to regions and village funds. This then shows why other income cannot be used as a support in helping regional spending.

CONCLUSION

This study seeks to understand how regional spending is influenced by regional income, focusing on the provinces of Indonesia. The research holds considerable significance in providing insights into effective budget management by regional governments to promote economic growth and development. The results highlight Funds Transferred to Villages and Regions to Regions and Village Funds on Regional Spending. However, the findings also indicate the lack of a significant relationship between Other Income and Regional Spending. The study underscores the importance of considering Original Income, Transfers to Regions, and Village Funds when making decisions about budget allocation and utilization for Regional Spending. As a practical implication, regional governments can enhance Regional Original Income and optimize the management of Funds Transferred to Villages and Regions to support improved Regional Spending.

LIMITATION

This research is limited to the years used, namely, only three years of study. This research is also limited to income and expenditure at the provincial level only. This research also only researches the relationship between regional income and spending.

Further research can add years of study and even carry out further research in regions according to the year of leadership of the regional leader. Further research can also be on regional income and expenditure in Indonesia's district/city level. Future research can make comparisons with other countries that implement fiscal decentralization. Future research can also add moderating variables to regional financial performance to see the impact of income on regional spending.

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