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Taxes, Revenues and Capital Expenditure as Determinants of Financial Sufficiency of Regional Government

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Abstract:

Purpose: *This study aims to investigate the influence of regional taxes and other legitimate regional revenues for regional financial sufficiency in Indonesia.*
Design/methodology/approach: *The research data was involved a sample of 27 districts/cities in Central Java, Indonesia. The sampling methodology used in this study is a purposive method. The hypothesis testind is based on Structural Equation Modeling through path analysis with the AMOS V. 22.*
Findings: *Regional taxes directly have a significant and positive effect on regional sufficiency, while other regional revenues directly influence significantly but negatively regional sufficiency. Special allocation of funds do not directly affect regional sufficiency. Indirect effect by using analysis on mediating effect of capital expenditure revealed that taxes, revenues, and special allocation funds revealed that capital expenditure is not able to have significant effect on the relationship between taxes, revenues, and funds to financial sufficiency.*
Practical implications: *The findings imply to local governments to further increase the utilization of existing resources in order to increase revenues which in turn, can increase the level of regional financial sufficiency.*
Originality/value: *The study originally examines the effect of special allocation funds with the realization of capital expenditure as a mediator.*

Keywords: *Tax, revenues, special allocation funds, capital expenditure, financial sufficiency.*

JEL code: *H21.*

Paper type: *Research article.*

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1. Introduction

Studies in public policy showed that sufficiency is measured by the ability and authority to explore financial and asset sources, manage and use their finances autonomously, in managing regional government and its dependence on central government assistance (Ramandei *et al.*, 2020). Moreover, Halim and Kusufi (2012) stated that budget as a plan of activities realized in the form of financial decisions includes proposed expenditures that are estimated in a period of time, and proposals regarding steps to meet these expenditures. Mardiasmo (2002) states that the budget is a statement about the estimation of performance to be achieved during a certain period of time expressed in financial measures, while budgeting is a process or method for preparing a budget. Previous studies have revealed findings regarding the effects of fiscal policy in regions with various patterns of economic growth in Indonesia (Sugiyanto *et al.*, 2018; Furqan and Din, 2019; Suryanto *et al.*, 2017). Some, also analyzed the degree of regional financial independence as a consequence of contemporary decentralization in Indonesia (Ermawati and Aswar, 2020; Andriansyah *et al.*, 2019; Effendi, 2017; Hirdinis, 2019; Vokshi, 2018).

The sources of regional revenue obtained are used to finance the administration of government affairs and the development of the authority of the region. One component of regional expenditure is capital expenditure. Capital expenditure has an important role because it has a long-term useful life to provide services to the public (Lewis, 2013). The ability of local governments to manage regional finance is set forth in the regional budget which directly or indirectly reflects the ability of local governments to finance the implementation of government tasks, development and social services of the community. This study aims to investigate the influence of regional taxes, other legitimate regional revenues, and special allocation of funds for regional financial sufficiency both directly and indirectly with the realization of capital expenditure as a mediator (Suharno and Dini, 2018). The research data was involved in a sample of 27 districts/cities in Central Java, Indonesia.

2. Literature Review and Hypotheses

2.1 Regional Taxes, Revenues and Special Funds on Financial Sufficiency

The financial capability of a region is highly related to its capacity to collect taxes as a mandatory contribution. In Indonesia, tax collection in some degrees was decentralized to the autonomous region which is owed by an individual or entity that is a force based on the Law, by not getting compensation directly and used for regional needs (Nasution, 2017). Ferro and Lentini (2014) states that sufficiency in Brazil can be achieved through the management of property sanitation by regional governments, so the financial management in local context can be managed sufficiently. Some studies found that regional taxes have a positive effect on financial sufficiency in Indonesian context (Tirtosuharto, 2010; Ermawati and Aswar, 2020; Nggilu, 2016). By analyzing the relationship between capital expenditure, regional original revenue, regional independence and regional economic growth. Apriana and Suryanto (2016) found that regional own-source revenues had a positive and significant impact on regional sufficiency in the districts in Java and Bali for example. Tahar and Zakhiya (2016) also found that regional income has a positive effect on sufficiency. Nofiyanto (2005) shows that revenue sharing has a positive effect on the level of financial sufficiency. Tahar and Zakhiya (2016) also found that special allocation funds has a positive effect on sufficiency. Liapis *et al.* (2020) investigate tax revenues and tax rations in selected OECD states.

H1: Local taxes have a significant effect on the level of financial sufficiency.
H2: Other legitimate regional revenues have a significant effect on the level of financial sufficiency.
H3: Special allocation funds have a significant effect on the level of regional sufficiency.

2.2 Regional Sufficiency and Mediating Effect of Capital Expenditures

Higher regional own-source revenues in a region will enable it to finance large capital expenditures. Sumarmi (2010) states that regional revenues in the form of taxes will affect local government budget. Moreover, Ermawati and Aswar (2020), Nggilu (2016) stated that regional taxes have a positive effect on financial sufficiency. The increase in other legitimate regional income used for regional development will likely increase the capital expenditure (Suranto, 2018). Apriana and Suryanto (2016) found that regional own-source revenues had significant impact on regional sufficiency in the districts.

However, Apriana and Suryanto (2016) also noted that capital expenditure has a negative and not significant effect on regional sufficiency. On the other hand, Sumarmi (2010) states that regional revenues have a significantly positive effect on regional capital expenditure. This is also supported by previous studies (Pelealu, 2013; Tuasikal, 2008) which states that capital expenditure has a significant effect on financial independence in the region. Pelealu (2013) shows that special allocation funds have a positive and significant effect on the Manado municipal government capital expenditure. Likewise, Sumarmi (2010) found that the allocation fund particularly has a significant and positive effect on the allocation of regional capital expenditure. On other hand, Tuasikal (2008) states that special allocation funds have an influence on capital expenditure. Booth (2011) and Scooled (2014) also found that the existence of separation and separation of budgets can increase the level of sufficiency in Scotland.

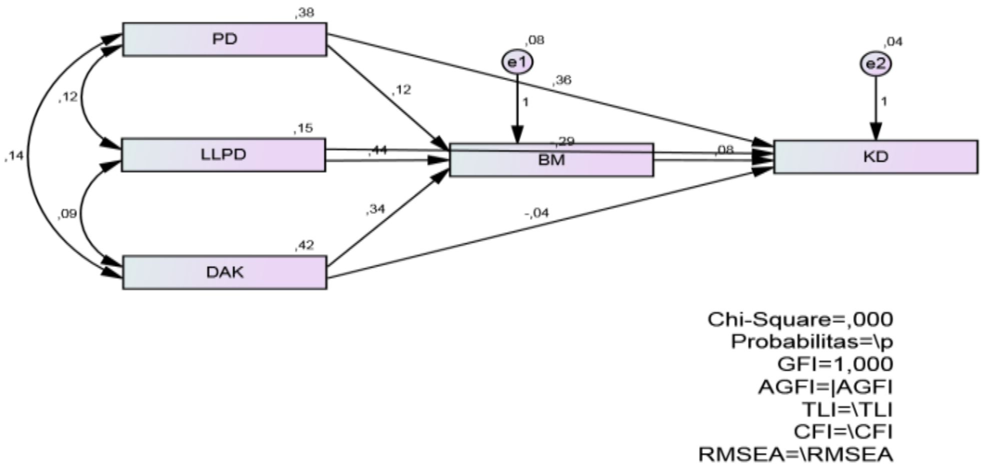
H4: Regional taxes mediated by capital expenditure have a significant effect on regional sufficiency.
H5: Other legitimate regional revenues mediated by the realization of capital expenditure have a significant effect on regional sufficiency.

H6: Special allocation funds mediated by the realization of capital expenditure have a significant effect on regional sufficiency.

3. Methods

This research is a quantitative research. The data was obtained in the form of numbers and processed using statistical analysis. The population of this study was 35 regencies/cities in Central Java Province (Table 1). The sampling methodology used a purposive sampling method. The data analysis used in this study is with Structural Equation Modeling (SEM) Path Analysis with AMOS Version 22 Software (Figure 1).

Figure 1. *SEM path analysis diagram*



Source: *AMOS Version 22 software.*

Table 1. *Selection of Research Samples*

No.	Criteria	Total
1.	Local Government Financial Reports 2012-2016	35
2.	Complete data of Taxes, Other Revenues, Special Funds, Expenditures	35
3.	Regional Financial Reports applicable to PSAP	35
4.	Outliers	(8)
Number of Samples		27
Total Observation (27 x 5 years)		135

Source: *Own calculations.*

Regional tax is defined as a compulsory contribution to the autonomous region which is owed by an individual or entity that is of a nature based on the Law. Other revenues are all regional revenues than regional income and transfer income, which include grants, emergency funds, and other income in accordance with the provisions of the legislation. Special allocation funds are funds originating from state budget and revenues allocated to certain regions with the aim of helping fund special activities which are regional affairs and in accordance with national priorities.

The endogenous variable, regional sufficiency is a ratio that shows the ability of local governments to finance their own government activities, development and services to communities that have paid taxes and levies as a source of income needed by the regions. As an intervening variable, capital expenditures are expenditures carried out in the context of capital formation which in nature add fixed assets/inventory that provides benefits for more than one accounting period.

4. Results

The results on the analysis of Goodness of Fit showed that the chi square value of 0.000 is obtained with the GFI value of 1.000 > 0.90 and the Df value of 0.000 = 0.000 indicates that the suitability test of this model produces a good acceptance.

Table 2. *Criteria for Goodness of Fit Index*

Indices	Cut-off Value	Results	
Chi-Square	0.00	0.00	Good
Sig. Prob	≤ 0.05	0.00	Good
GFI	≥ 0.90	1.00	Fit

Source: *Own calculations.*

Hypothesis testing showed that regional tax has a significant effect on the level of regional sufficiency, meaning that regional sufficiency, measured through the ability to autonomously explore and manage resources, still depends largely on how large local taxes are as a source of income for the region. The statistical calculation revealed the the C.R value of 11.109 with p-value of 0.00 < 0.05, meaning that there is a positive and significant effect. Thus, the greater regional tax revenue as part of regional own-source revenues, can directly increase absorption and regional financing. Thus, the first hypothesis stating the significant effect of regional taxes on financial sufficiency was accepted. This finding is consistent with Nggilu (2016) which states that local taxes and local revenues, which are regional autonomy, are significant towards the level of regional sufficiency.

The second hypothesis states that there a significant effect of regional revenues on financial sufficiency. The results revealed the C.R value of -5.129 with p-value of 0.00 < 0.05, meaning that there is a negative and significant effect. This confirms that other legitimate revenues have a significant effect on the level of regional sufficiency. Thus, the second hypothesis is accepted (Table 3).

Table 3. *Regression Weight*

Hypothesis			**Estimate**	**C.R**	***p***
Sufficiency	<---	Taxes	.364	11.109	***
Sufficiency	<---	Revenues	-.292	-5.129	***
Sufficiency	<---	Funds	-.041	-1.199	.230

Source: *Own calculations.*

However, the next testing for the effect of special allocation fund on financial sufficiency showed that there is no significant effect. The calculation showed that special allocation fund originating from central government transfer funds has no significant effect on the level of regional sufficiency, reflected by the C.R value of -0.41 and *p*-value of 0.230 > 0.05. Thus, the third hypothesis is rejected. This is not consistent with Booth (2011) and Scooled (2014) which states that the existence of separation and separation of budgets can increase the level of financial sufficiency in Scotland. This is maybe caused by the fact that special allocation fund is not constant in nature, so it is not able to contribute highly to the level of regional sufficiency.

Furthermore, the calculation of indirect effects using the mediation expenditure variable produces a value of t of 1.11688 ($p > 0.05$) for the relationship between tax and sufficiency, t of 1.27259 ($p > 0.05$) for the relationship of revenues and sufficiency and t of 1.29491 ($p > 0.05$) for the relationship between funds and sufficiency. These results explain that expenditure is not able to mediate the relationship between exogenous variables of taxes, revenues and funds with sufficiency.

Thus, the fourth, fifth and sixth hypotheses are rejected. This is not consistent with Ferro and Linteni (2014) which states that expenditure contributes significantly in selected developed countries. This confirms that mediating variable of expenditure did not been able to mediate the effect indirectly, from the regional taxes, other revenues and special allocation funds. This maybe caused by the fact that the average realization of capital expenditure absorption in the region has not been significant. The data on capital expenditure absorption in Central Java Province showed the average is still around 30-45 percent of the total budgeted capital expenditure.

5. Conclusions

The findings showed that there is a partially significant and positive influence between regional taxes and regional sufficiency. Local taxes are components of regional own-source revenues. The findings also revealed a partial and significant negative influence of other legitimate regional revenues and the sufficiency. However, there is an insignificant influence of special allocation funds on regional sufficiency. Furthermore, the analysis of mediating effect showed that capital expenditure is not able to strengthen the influence of taxes, revenues and funds on regional sufficiency. Practically, the findings imply to local governments to further increase the utilization of existing resources in order to increase revenues so that the level of regional sufficiency increases and to maximize the existing budget to be used as needed.

The limitations of this study are that this research is only conducted in a span of 5 years from 2012-2016, and variables used in this study are only limited to three exogenous variables, one endogenous variable and one intervening variable. Furthermore, this study does not use hypothesis testing simultaneously to test the assumptions of SEM limited to normality, multicollinearity, and outliers. Future studies are able to use more accurate data by increasing the amount of data and the time span of research, and to add more exogenous and endogenous variables. It is also expected to involve intervening variables by using more complete test tools and methods as well as by using simultaneous analysis.

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