

Analysis of Local Government Financial Ratios and Their Impact on Capital Expenditures for Economic Growth in East Java Province

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ABSTRACT

This study aims to analyze the effect of regional financial ratios on capital expenditure and their implications for economic growth in East Java Province. The financial ratios examined include the independence ratio, effectiveness ratio, and efficiency ratio as indicators of local government financial performance. Capital expenditure is positioned as an intervening variable that plays a role in supporting infrastructure development and productive sectors. This research employs a quantitative approach using data analysis from regional government financial reports. The results indicate that the regional independence ratio has a positive effect on capital expenditure, which in turn contributes to economic growth. Meanwhile, the effectiveness and efficiency of regional financial management also play a significant role in optimizing the allocation of development budgets.

INTRODUCTION

The economic growth of a region is inseparable from the effectiveness of regional financial management, especially in the allocation of capital expenditure. East Java Province as one of the regions with the largest economic contribution in Indonesia requires an in-depth analysis related to regional financial ratios, such as independence ratios, effectiveness ratios, and efficiency ratios. And to assess the extent to which fiscal policy affects infrastructure development and productive sectors. Capital expenditure is a crucial component in the Regional Revenue and Expenditure Budget (APBD) which must be managed optimally in order to be able to encourage long-term economic growth.

The inequality of development between districts/cities in East Java demands further evaluation of the relationship between regional financial performance and its impact on capital expenditure. Financial ratio analysis can be an indicator to measure the fiscal capacity of local governments to support public investment, which ultimately affects labor absorption, productivity increase, and regional economic growth. This study aims to identify how much regional financial ratios affect the effectiveness of capital expenditure and its implications for the economic development of provincial regions in East Java.

LITERATURE REVIEW

The Effect of Independence Ratio on Regional Economic Growth

Regional independence can be measured by the level of each Regional Original Income by looking at the annual report, whether it has increased each year from the previous one. And from there we can also see the burden incurred in each period by the local government. One of the important aspects in the implementation of regional autonomy and decentralization that is carefully regulated is the issue of regional financial management and regional budgets to realize regional autonomy and decentralization that is broad, real, and responsible, regional financial management is needed that is able to supervise and regulate regional financial policies economically, efficiently, effectively, transparently, and accountably (Randria, 2016).

Local Government Institutions are institutions that are authorized by the Central Government to implement and regulate the interests of the nation and state in the regions. Regional Government Institutions have the goal of carrying out development for the benefit of the general public by holding a Regional Autonomy program. This aims to advance each region under the authority of the Regional Government (Anggi, 2022). Good regional financial management is reflected in the region's ability to manage finances contained in the Regional Revenue and Expenditure Budget (APBD). This reflects the extent of the region's ability to finance the implementation of activities in its region, which is then assessed to determine the position of the local government in the implementation of its own local government (Oktaviani et al., 2022).

The source of regional income can come from the central government's assistance or from the ability of the local government itself. However, not all sources of central government financing can be provided to the regions. Local governments are required to be able to explore all their financial sources (Rifka Alkhilyatul Ma'rifat, I Made Suraharta, 2024). The ability of local governments to manage their finances is outlined in the Regional Revenue and Expenditure Budget (APBD) which describes the ability of local governments to finance all development activities. The APBD is the main policy instrument for local governments (Nurdiwati & Zaman, 2016).

The self-reliance ratio is an indicator that measures the extent to which a region is able to finance its own government expenditures without relying on transfers from the central government. This ratio is calculated by comparing Regional Original Revenue (PAD) to total regional spending. The higher the independence ratio, the more independent a region will be in managing its finances. The self-sufficiency ratio is important because it reflects the ability of the region to explore the potential of the local economy and reduce dependence on external funding sources.

Regional economic growth is influenced by various factors, one of which is the region's financial capabilities. A high independence ratio indicates that the region has a stable source of income and is able to manage the budget effectively. This can encourage infrastructure development, improved quality of public services, and the creation of a conducive investment climate, which ultimately contributes to economic growth. For example, in the regions, taxes are collected based on the rates that have been determined by the Central Government.

One of the important aspects in the implementation of regional autonomy and decentralization that is carefully regulated is the issue of regional financial management and regional budgets to realize regional autonomy and decentralization that is broad, real, and responsible, regional financial management is needed that is able to supervise and regulate regional financial policies economically, efficiently, effectively, transparently, and accountably (Harahap, 2020). Transparency or openness that is urgently needed by the public is the accountability of local government financial management. Meanwhile, accountability for regional financial management must be supported by the government's economic system that is able to provide information for the purpose of accountability (stewardship and accountability), controlling and supervising or controlling local government management (Hafidh, 2013).

Regions with a high independence ratio tend to be more independent in planning and implementing development programs. They can allocate budgets to strategic sectors such as education, health, and infrastructure, which are the foundation for long-term economic growth. In addition, fiscal independence also reduces the risk of delays or uncertainty in receiving funds from the central government. Regions with low self-sufficiency ratios often face obstacles in financing development programs due to their dependence on transfers from the central government. This can hinder economic growth because regions have difficulty in optimizing local potential and creating jobs. In addition, high dependency can reduce regional flexibility in responding to community needs.

Financial ratio is a formula used to assess the growth of an organization or local government, by using financial reports for a certain period as material for analysis or a certain year's budget as material for future evaluation. The analysis used is the PAD effectiveness ratio, regional financial effectiveness ratio, independence ratio, spending activity ratio, and PAD growth ratio (Julaeha & Penangsang, 2024). Regional Original Revenue (PAD) plays a key role in increasing the self-reliance ratio. PAD can come from regional taxes, levies, and natural resource management results. Regions that are able to explore the potential of PAD optimally will have a more stable source of income and can reduce dependence on transfers from the central government. The increase in PAD also shows that regions are able to manage local resources effectively.

The definition of effectiveness is related to the degree of success of an operation in the public sector so that an activity is said to be effective if the activity has a great influence on the ability to provide community services which is a previously set target (Zulkarnain et al., 2019). The central government can encourage an increase in the ratio of regional independence through a fiscal decentralization policy that gives greater authority to the regions in managing their finances. In addition, the government can also provide incentives to regions that have succeeded in increasing PAD and reducing dependence on transfers. This policy can encourage regions to be more creative in exploring sources of income and optimizing local potential.

Financial ratio is a formula used to assess the growth of an organization or local government, by using financial reports for a certain period as material for analysis or a certain year's budget as material for future evaluation. The analysis used is the PAD effectiveness ratio, regional financial effectiveness ratio, independence ratio, spending activity ratio, and PAD growth ratio (Julaeha & Penangsang, 2024). Some regions in Indonesia, such as East Java, have a relatively high independence ratio. These areas are able to explore the potential of the local economy through the tourism, industry, and trade sectors. This high self-reliance ratio contributes to stable economic growth and improved people's welfare. These regions are also more independent in financing development programs and reducing dependence by the central government.

On the other hand, some regions in Indonesia still have a fairly low independence ratio due to high dependence on transfer funds from the central government, for example. These areas often face obstacles in financing development programs and optimizing local potential. This low self-reliance ratio can hinder economic growth and cause inequality in development between regions. To increase the self-reliance ratio in an area, it is necessary to optimize the local economic potential through increasing PAD. This can be done by increasing efficiency in tax collection and levies, as well as by developing superior sectors, as well as attracting private investment. In addition, the regions also need to increase transparency and accountability in financial management to ensure that the budget is used effectively and efficiently.

Infrastructure is an important factor in driving economic growth. With a region with a high independence ratio, it can allocate a budget for infrastructure development such as roads, bridges, and public facilities. Good infrastructure development will increase people's mobility, facilitate the distribution of goods and services, and attract investment from outside the region. On the other hand, areas with low self-sufficiency ratios may have difficulty financing infrastructure development, which can hinder economic growth in an area.

The community also plays an important role in increasing the ratio of regional independence. By paying taxes and levies on time, the community contributes to the increase in PAD. In addition, community participation in local economic activities, such as MSMEs and tourism, can encourage regional economic growth. Public awareness of the importance of fiscal independence can also encourage local governments to be more transparent and accountable in financial management. Regional financial ratio analysis is a method in measuring regional financial performance. This is done to find out how much responsibility the local government has for the financial management of its region. Not only can it show how public funds are used, but it can also show that they are used economically, efficiently, and effectively (Bharata et al., 2023).

The independence ratio is an important indicator that affects regional economic growth. With a high independence ratio, they tend to be more independent in managing their finances, able to finance development programs, and creating a conducive investment climate. On the other hand, regions with low self-sufficiency ratios often face obstacles in financing development and optimizing local potential. Therefore, increasing the self-reliance ratio through PAD optimization, with supportive government policies, and community participation is the key to sustainable regional economic growth in the future.

One way to increase the self-reliance ratio is to diversify regional sources of income. Regions should not rely solely on one or two sources of revenue, such as taxes or levies, but need to develop other potential sectors, such as tourism, creative industries, or technology-based agriculture. This diversification not only increases PAD but also reduces the risk of income fluctuations if a sector declines. Thus, the region can be more financially stable and able to support sustainable economic growth.

The use of technology can be a solution to improve the efficiency of PAD collection, which ultimately encourages an increase in the self-reliance ratio. For example, an online tax system or levy payment application can make it easier for taxpayers to fulfill their obligations while reducing revenue leakage. In addition, technology can also be used to monitor and analyze regional revenue potential in real-time, so that local governments can take more appropriate and effective policies in exploring new sources of revenue.

Collaboration between regions can be an effective strategy to increase the self-reliance ratio. Regions with similar economic potential can work together to develop leading sectors, such as forming joint industrial estates or developing integrated tourism destinations. In addition, this collaboration can also include knowledge exchange and best practices in regional financial management. Thus, these regions are not only able to increase their respective PAD but also create synergies that encourage overall regional economic growth.

The increase in the self-reliance ratio is also highly dependent on the capacity of human resources (HR) in the regions. Local governments need to provide education and training to the State Civil Apparatus (ASN) and the community in terms of financial management, taxation, and local economic development. With competent human resources, regions can be more effective in exploring revenue potential and managing budgets efficiently. In addition, educated people will also be more aware of the importance of paying taxes and levies, which also contribute to the increase in PAD.

The allocation of the APBD for regional expenditure distributed to development sectors will encourage regional development and the overall rate of economic growth. The development of production activities in the region with development activities financed by the local government will increase investment that enters the area, which in the end will increase the growth rate of the regional economy (Rante et al., 2018).

Institutional strengthening at the regional level is an important factor in increasing the independence ratio. A strong and transparent institution can ensure that regional financial management is carried out in an accountable manner and in accordance with the principles of good governance. This includes the implementation of effective oversight systems, open financial reporting, and active participation of the community in decision-making. With good institutions, investor and public trust in local governments will increase, ultimately driving economic growth and fiscal independence.

METHODOLOGY

This study uses a quantitative approach because it aims to test the relationship between variables in a measurable and objective manner. The data used is secondary data derived from the financial statements of local governments in East Java Province, especially those related to the Regional Revenue and Expenditure Budget (APBD). The variables analyzed in this study consist of regional financial ratios as independent variables, namely the independence ratio, effectiveness ratio, and efficiency ratio. Meanwhile, capital expenditure is used as an intervening variable that bridges the influence on economic growth as a dependent variable. The data collection technique is carried out through documentation, namely by collecting regional financial reports that have been officially published. The data is then analyzed using statistical analysis methods, such as regression analysis, to see the direct and indirect effects between variables.

RESEARCH RESULT

The results of the study show that regional financial ratios have an important role in determining the amount of capital expenditure allocation in East Java Province. The ratio of regional independence has been proven to have a positive influence on capital expenditure. This means that the higher the ability of the regions to finance their own needs through Regional Original Revenue (PAD), the greater the opportunity for local governments to increase investment in the form of infrastructure development and public assets. In addition, the effectiveness ratio also showed a significant influence. When the realization of regional revenue is able to reach or even exceed the set target, local governments have a wider fiscal space to allocate the budget to capital expenditure. This shows that good planning and achievement of revenue targets greatly support development activities.

On the other hand, the efficiency ratio also contributes to the optimization of capital expenditure. Efficient budget management allows local governments to use available resources to the fullest without waste. Thus, the quality of the resulting capital expenditure becomes better and on target. Furthermore, this study found that capital expenditure plays a role as an intervening variable that links regional financial ratios with economic growth. Increasing capital expenditure, especially in infrastructure development, has been proven to be able to encourage economic activity, increase productivity, and create jobs. As a result, regional economic growth has also increased.

DISCUSSION

Regional financial management is one of the main pillars in supporting the success of a region's economic development. In the context of regional autonomy, local governments have broad authority in managing the financial resources they have. Therefore, analysis of regional financial ratios is important to assess the extent to which fiscal performance is able to support expenditure allocation, especially capital expenditure which has a direct impact on economic development. Regional financial ratios are basically an analytical tool used to evaluate the performance of local government financial management through data contained in financial statements, especially the Regional Revenue and Expenditure Budget (APBD). This ratio not only serves as an evaluation tool, but also as a basis for decision-making in budget planning in the next period. In this study, the ratios used include the independence ratio, the effectiveness ratio, and the efficiency ratio.

The regional independence ratio describes the ability of local governments to finance their spending needs independently without relying significantly on transfer funds from the central government. This ratio is calculated by comparing Regional Original Revenue (PAD) to total regional revenue or expenditure. The higher this ratio, the greater the level of fiscal independence of a region. This shows that the area is able to explore its economic potential optimally.

In practice, regions with a high independence ratio tend to be more flexible in determining development priorities. They are not too tied to the terms of use of transfer funds which usually have certain restrictions. Thus, local governments can more freely allocate budgets to strategic sectors such as infrastructure, education, and health that directly contribute to improving the quality of life of the community. In contrast, areas with low self-reliance ratios show a high level of dependence on the central government. This condition can hinder the development process due to the limited fiscal space available. In addition, this dependence also has the potential to cause uncertainty in budget planning, especially if there is a delay in the distribution of transfer funds.

The effectiveness ratio is an indicator used to measure the extent to which regional revenue realization is able to achieve the set target. This ratio is usually calculated by comparing the realization of PAD to the target PAD. A high level of effectiveness shows that the local government is able to optimize the revenue potential it has in accordance with the planning that has been prepared. The effectiveness of regional financial management greatly affects the government's ability to finance capital expenditure. When regional revenues are realized optimally, the Government has greater fiscal space to finance infrastructure development and other productive programs. This will ultimately have an impact on increasing economic activity in the area.

Meanwhile, the efficiency ratio is related to the ability of local governments to manage expenditure economically and on target. This ratio measures the ratio between the costs incurred and the results obtained. Efficient financial management reflects the optimal use of resources without waste. Efficiency in budget management is essential, especially in the context of capital expenditure. Efficient capital expenditure will result in quality public assets, such as roads, bridges, and other public facilities. Good infrastructure will improve connectivity between regions, facilitate the distribution of goods and services, and encourage the growth of productive economic sectors. Capital expenditure itself has a strategic role as an intervening variable in the relationship between regional financial ratios and economic growth. This is because capital expenditure is directly related to physical development which is the foundation for economic activities. Government investment in the form of capital expenditure will create a multiplier effect that can increase people's income and create jobs.

In East Java Province, as one of the national economic centers, capital expenditure management is very crucial. The high level of economic activity in this region requires adequate infrastructure support. Therefore, increasing the ratio of independence, effectiveness, and financial efficiency of the region will greatly determine the success of economic development in the region. The relationship between the ratio of independence and capital expenditure shows that regions that are able to increase PAD tend to have a larger allocation of capital expenditure. This is due to the increase in the region's fiscal ability to finance development without relying on external funds. Thus, increasing PAD is one of the main strategies in strengthening regional financial capacity.

Regional Financial Independence Ratio

The capacity of local governments to manage and fund their own government, development, and community assistance activities using tax and levy sources is what is called regional financial independence. This capacity is measured by comparing PAD with other sources of revenue, such as regional loans and central or provincial government assistance. To calculate the Independence Ratio, you can use the following formula (Bharata et al., 2023).

$$\text{RKKD} = \frac{\text{Regional Original Revenue}}{\text{Transfer Income}} \times 100\%$$

The higher the value of the ratio, the lower the level of regional dependence on external aid, and vice versa. Regional financial independence ratio increases Along with community involvement in the regional development process; the higher this ratio, the more efforts the community will have to engage in the payment of levies and taxes, which are the main source of regional revenue (Bharata et al., 2023).

In addition, effectiveness in revenue management also plays a role in ensuring that budget targets can be achieved. When revenue realization meets or even exceeds the target, local governments can expand spending, including capital expenditure. This will have a positive impact on economic growth through increased public investment. Expenditure efficiency is also no less important in supporting the optimization of capital expenditure. Efficient spending will ensure that every rupiah spent provides maximum benefits to the community. Thus, the quality of development can be improved without having to increase the budget burden excessively.

Regional economic growth is ultimately the result of the synergy between good financial management and proper spending allocation. Infrastructure built through capital expenditure will increase economic productivity, attract investment, and expand employment opportunities. This will have an impact on increasing people's income and overall welfare. To achieve this condition, continuous efforts are needed to improve the quality of regional financial management. One of them is by optimizing PAD sources through policy innovation and technology utilization. Digitizing the tax and levy system can be a solution to increase transparency and reduce revenue leakage.

In addition, increasing the capacity of human resources within local governments is also a key factor. Competent officials will be able to manage finances professionally and accountably. This will increase public trust in local governments and encourage community participation in development. Strengthening the supervision and accountability system also needs to be done to ensure that regional financial management runs in accordance with the principles of good governance. Transparency in financial reporting will provide a clear picture of budget usage and the results achieved.

CONCLUSIONS AND RECOMMENDATIONS

Based on the results of the research that has been conducted, it can be concluded that the regional financial ratio has a significant influence on capital expenditure and economic growth in East Java Province. The regional independence ratio is the most powerful factor in encouraging an increase in capital expenditure. Regions that are able to optimize Regional Original Revenue (PAD) tend to be more independent in determining development policies and are less dependent on transfer funds from the central government. The ratio of effectiveness and efficiency also plays an important role in supporting better budget management. Effectiveness ensures that revenue targets can be achieved, while efficiency guarantees that the budget is used appropriately and not wastefully. The combination of the two will result in an optimal allocation of capital expenditure.

ADVANCED RESEARCH

Capital expenditure it self has proven to be the main link between regional financial performance and economic growth. Investment in the form of infrastructure development and public facilities has a real impact on increasing economic activity and community welfare.

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