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The Characteristics and Financial Performance of Local Governments in Indonesia: The Moderating Role of Financial Health Level

Amrie Firmansyah [1]✉, Zef Arfiansyah [2], and Arifudin Miftakhul Huda [3]

[1]*Faculty of Economics and Business, Universitas Pembangunan Nasional Veteran Jakarta, Indonesia*
[2]*Departmenet of Public Sector Accounting, Polytechnic of State Firnance STAN, Indonesia*
[3]*Secretariat General, Ministry of Finance, Indonesia*

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ABSTRACT

Purpose : The study investigates the impact of capital expenditure and the dependency level on the financial performance of local governments in Indonesia. This study also incorporates the level of financial stability as a moderating factor.
Method : The study utilizes local government financial data from www.djpk.kemenkeu.go.id, a website that provides information on the finances of local governments in Indonesia. This study generated a comprehensive sample of 630 observations using purposive sampling. Hypothesis testing was done using multiple linear regression analysis for cross-section data.
Findings : The findings of this study indicate that capital expenditure has a favorable impact on the financial performance of local governments. However, the degree of dependency adversely influences their financial performance. Furthermore, the degree of financial stability does not enhance the favorable correlation between capital expenditure and the financial success of local governments. Financial soundness does not mitigate the unfavorable correlation between reliance level and the financial performance of local governments.
Novelty : The analysis incorporates the financial stability of local governments as a moderating factor in the impact of capital spending and the extent of reliance on local government financial performance. This aspect has been relatively unexplored in prior studies. This research also contributes to the existing literature on the financial well-being of local governments, a topic seldom examined in the field of public sector accounting in Indonesia.

INTRODUCTION

The implementation of fiscal decentralization in Indonesia for over two decades aims to empower local governments to enhance the well-being of their constituents by providing essential services to the community (Puspita et al., 2021). Nevertheless, fiscal decentralization may not always be optimal and may not be effectively implemented by all local governments in Indonesia. As Liu (2011) identified, not all fiscal decentralization implementations have been successful. Fiscal decentralization is delegating expenditure and revenue functions to the local government level (Liu, 2011). There are three types of decentralization: broad decentralization of income/expenses, narrow decentralization of revenues/expenditures, transfer of income, absolute decentralization, and political centralization only and the state (Liu, 2011). Traditionally, support for decentralization policy has focused on the economic benefits derived from its use (Liu, 2011). Local governments are presumed to possess superior knowledge of the demographics of their specific jurisdictions, enabling them to deploy public resources with greater efficiency and effectiveness than the central government.

It is essential to encourage local governments to improve their fiscal performance due to fiscal decentralization. The financial success of local governments depends on their ability to maximize local revenue opportunities (Riesdi, 2024). Fiscal decentralization is expected to incentivize local governments to generate revenue sources and decrease reliance on the central government (Puspita et al., 2021). In this context, the central government's interven-

* *E-mail: amriefirmansyah@upnvj.ac.id*
Address: Jl. RS Fatmawati, Pd. Labu, Kec. Cilandak, Kota Jakarta Selatan, Daerah Khusus Ibukota Jakarta 12345, Indonesia

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tion through transfers aims to boost the independence of local governments in managing their affairs. Further fiscal decentralization aims to avoid regional local governments consistently relying on central government transfer funds for development projects. Instead, regional governments should create development plans that leverage regional potential to generate local revenue. The principle behind government transfers to local governments in the framework of fiscal decentralization is focused on fostering independent financial management, including the planning of local revenue sources (Puspita et al., 2021). However, local governments face challenges in generating original revenue due to certain high-value taxes collected by the central government (Klikpajak.id, n.d.). Therefore, local governments need to optimize their revenue sources, apart from those taxes collected by the central government.

Fiscal decentralization should enable regional governments to fully utilize their potential for generating local revenue. However, many local governments have yet to achieve this (Puspita et al., 2021). Local governments are often seen as inefficient in budget allocation and cannot generate revenue from local sources (Badan Pemeriksa Keuangan, 2021). The ability of local governments to secure local revenue is closely tied to their fiscal success. Efficient financial management by local governments will reduce their dependence on central government transfer funds.

The poor financial performance of local governments suggests a continued inability to plan and generate regional revenue effectively. Although the goal of fiscal decentralization has been to encourage greater self-sufficiency in funding regional development, local governments are still expected to reduce their reliance on central government transfers. In pursuing development, local governments need to engage stakeholders in improving policies related to financial performance. They must also be more accountable and transparent in designing development programs, aiming for greater stakeholder involvement to ensure more professional local government management. A key aspect of this management is the enhancement of local revenue streams, ensuring that local governments are not perpetually dependent on central government funds. Consequently, further research is necessary to explore the financial performance of local governments.

This research empirically investigates the impact of capital expenditure and dependency level on the financial performance of local governments. These factors are intrinsically linked to local government characteristics, making them easily identifiable by various stakeholders. Capital expenditure is directly connected to the development of infrastructure within a region, involving the allocation of budgeted funds for acquiring long-term assets, including physical infrastructure or intangible assets with lasting value, and typically finances infrastructure projects that are easily recognizable by the public (Nuryani & Firmansyah, 2020; Peraturan Pemerintah RI, 2010).

Infrastructure, in turn, is essential for providing basic services to the community and encourages local governments to develop potential regional revenue sources. Numerous previous studies have suggested that capital expenditure positively influences the financial performance of local governments (Digdowiseiso et al., 2022; Ramadana & Bahgia, 2023; Simamora & Budiwitjaksono, 2022). Allocation of funds for infrastructure and long-term assets can increase operational efficiency, attract investment, and strengthen regional revenue potential, thereby reducing dependence on fund transfers from the central government. Meanwhile, Firmansyah (2024), Nauw & Riharjo (2021), and Novita & Arza (2024) concluded that capital expenditure reduces the financial performance of local governments. Infrastructure projects are considered to take a long time to generate economic benefits, while high initial costs can increase the budget burden and disrupt the short-term financial balance. (Atmoko & Khairudin, 2022; Maulina et al., 2021; Padang & Padang, 2024) found that capital expenditure is unrelated to local government financial performance. Capital expenditures typically focus on long-term projects such as infrastructure, whose impact on financial performance may not be immediately visible in the short term. Research conducted over a short period may not capture the full impact of capital expenditures. Short-term studies may not capture the full impact of these expenditures, leading to inconsistent findings and underscoring the need for further investigation.

Additionally, the degree to which local governments rely on central government transfers is closely tied to their level of dependency. Under fiscal decentralization, regional administrations still heavily depend on central government funds to finance development in certain areas. Local governments face challenges in generating their revenue, necessitating the receipt of funds from the central government as a significant source of regional revenues. Maulina et al. (2021), Nauw & Riharjo (2021), Padang & Padang (2024), Setiani & Ismunawan (2022) concluded that the dependency level positively affects the local government's financial performance. Fund transfers from the central government are considered to provide financial stability, ensure funding for important projects, and help regions meet budget needs without having to rely entirely on local revenues that may not be optimal. However, several prior studies have found that high dependency negatively affects the financial performance of local governments (Adinata & Efendi, 2022; Digdowiseiso et al., 2022; Firmansyah, 2024; Novita & Arza, 2024). High dependence on fund transfers from the central government is considered to reduce regional incentives to optimize original revenues, weaken independent financial management initiatives, and create an ongoing dependency that hinders fiscal independence. Meanwhile, Nauw & Riharjo (2021) concluded that the level of regional dependence does not affect local government performance. Local governments can manage the funds received effectively and efficiently so that dependence on central transfers does not become a major determining factor in their financial performance. With good management, regions can still achieve optimal financial performance. The difference in the results of the previous tests resulted in the need to reexamine the effect of the level of dependence on local government financial performance.

District/city government data from a particular region or province was used in previous studies. Meanwhile, this study uses data from district/city governments across Indonesia to produce test findings that are more accurate and reflect the state of Indonesia as a whole. In addition, other studies examine the financial performance of local governments descriptively by utilizing data from one local government over a certain period (Firmansyah, 2024; Hafizi & Amalia, 2022; Lada et al., 2021; Novita & Arza, 2024; Purwanti & Noviyanti, 2022; Putri & Munandar, 2021; Yulinchton et al., 2022).

Furthermore, this study employs financial health as a moderating variable in the influence of capital expenditure and the level of dependence on local government financial performance in this study. The local government's ability to pay for all its expenditures, including its commitments, is considered financial health (Muñoz et al., 2016). Local governments can pay off all their commitments while prioritizing their demands if they have sufficient financial resources. As a result, the ability of local governments to repay their debts after financing statutory expenditures is indicative of financially sound local governments.

Fiscal sustainability refers to the government's responsibility to guarantee that its fiscal policies can be maintained over a prolonged period while also implementing policies that promote fairness and equity among different generations (Sinervo, 2020). Local governments with loans face more excellent productivity prospects (Sinervo, 2020). Local governments often use debt to finance large infrastructure projects such as roads, bridges, transportation systems, or other public facilities. Investment in this infrastructure can increase economic efficiency, encourage private investment, and create jobs, which have an impact on increasing local revenues and public welfare. In addition, debt can be used to cover budget deficits, especially if the local government has urgent needs that must be met. Although debt has high risks, under certain conditions, the use of debt can be a useful tool to maintain fiscal stability and provide time for local governments to adjust revenue and expenditure policies. In addition, the government is vulnerable to unforeseen circumstances (Navarro-Galera et al., 2017). Effective financial management is crucial for maintaining financial well-being since local governments are proficient in managing financial resources (Suryawati et al., 2018). The fiscal health of local governments also influences the government's budget allocation, therefore impacting the allocation of capital spending. The financial well-being of local governments also enhances their financial resilience, enabling them to more effectively manage and reduce the risks associated with uncertain financial circumstances in the future. Local governments are financially independent from the central government if they have strong financial stability. Hence, the fiscal health of local governments plays a crucial role in enhancing the caliber of capital investments and diminishing local governments' reliance on the federal government.

This study includes control variables, such as local government size and financial statement quality. The size of the area is an indication related to the resources owned by the local government in carrying out its activities (Firmansyah et al., 2022). In addition, the size of the area is related to the ownership of local government assets for the implementation of the government (Nuryani & Firmansyah, 2020). Large-scale regional governments are more capable of managing their resources (Firmansyah et al., 2022). Regional governments can more optimally generate local revenue sources if they are supported by large asset ownership. Adinata & Efendi (2022) found that the larger the size of the local government, the higher the financial performance of the local government.

The quality of financial statements can show the quality of financial management by local governments. Adiputra et al. (2018), Annisa & Murtini (2018), Nainggolan & Purwanti (2016), Nor et al. (2019), and Pontoh et al., 2018) stated that the quality of their financial statements positively influences the level of transparency of local governments. The quality of financial statements serves as a measure of the quality of regional financial management. Therefore, obtaining a favorable judgment pushes local governments to enhance their performance.

This research expects to make several contributions. This research can complement the literature related to testing the financial performance of local governments in Indonesia. This research can also review the financial performance of local governments in Indonesia or other countries with similar decentralization characteristics. It is expected that the Ministry of Home Affairs will be able to use the results of this research to improve the policy of monitoring the implementation of regional government decentralization related to the ability of local governments to generate regional own-source revenue through infrastructure spending.

Stakeholder theory posits that organizations must involve various interests to thrive (Mahajan et al., 2023) they remain restricted to functional or niche areas. Specifically, no study, to date, has attempted to review ST research in its entirety. To address this noteworthy gap, this study endeavors to (i. Organizations engaging diverse stakeholders will likely be more transparent in public disclosures (Lauesen, 2013). One significant concern for many stakeholders in local government administration is capital expenditure, which is closely tied to infrastructure development. Stakeholders expect local governments to manage capital expenditures effectively and prioritize community needs as part of their public service role (Nuryani & Firmansyah, 2020). Capital expenditure, which involves allocating funds for long-term assets such as physical infrastructure or intangible assets (Peraturan Pemerintah RI, 2010)), directly impacts visible infrastructure that benefits communities and motivates local governments to explore potential sources of local revenue, thereby playing a crucial role in stakeholder engagement and transparency (Nuryani & Firmansyah, 2020).

Digdowiseiso et al. (2022), Ramadana & Bahgia (2023), and Simamora & Budiwitjaksono (2022) found that capital expenditure has a positive effect on local government financial performance. Regarding fiscal decentralization, local governments are responsible for acquiring local sources of revenue rather than solely relying on regional revenues derived from money sent by the central government. An important measure of the effectiveness of fiscal decentralization in Indonesia is the capacity of local governments to strategize and create local revenues, as this capacity directly impacts the financial performance of these governments.

H_1: Capital expenditure has a positive effect on local government financial performance

Stakeholders anticipate that an organization will conduct its activities transparently (Schnackenberg & Tomlinson, 2016). Furthermore, the organization must assess the repercussions of its decisions on stakeholders (Schnackenberg & Tomlinson, 2016). Implementing fiscal decentralization in Indonesia for over two decades should empower local governments to have autonomy in managing their governance. Local governments are anticipated to cease relying on financial assistance from the central government to administer their institutions (Puspita et al., 2021). Local governments must demonstrate accountability to stakeholders while implementing fiscal decentralization. Fiscal decentralization seeks to enhance regional autonomy in generating local revenue. Local governments rely on central government transfers as their primary source of cash to fund their regions' development. Despite implementing fiscal decentralization in Indonesia for over two decades, regional administrations that still rely on central government transfer money have constraints in generating local revenues (Puspita et al., 2021).

Adinata & Efendi (2022), Digdowiseiso et al. (2022), Firmansyah (2024), and Novita & Arza (2024) found that the dependency level negatively affects the local government's financial performance. Local governments continue to rely on central government transfer funds and are perceived as deficient in development planning regarding program activities that can generate original revenue sources at the regional level. Local governments rely heavily on central government transfer payments as their primary source of income due to their responsibility to carry out operations and provide basic services to the population.

H_2: The dependency level on local government negatively affects local government's financial performance

In the theory of fiscal sustainability, a government needs to ensure that fiscal policies capable of overcoming budget constraints have been implemented. Keynes first put forward this term in 1923 in response to the financial problems faced by the French government (Afonso, 2005). Afonso (2005) concluded that the government faces a fiscal sustainability problem when the revenue earned cannot cover the burden arising from new debt issuance, which can also be seen as the government's financial solvency. The government must maintain fiscal sustainability and financial health (Wibowo, 2023). Financial health can be seen as the government's ability to deliver public services and obligations (Kooij & Groot, 2021).

Fiscal decentralization in Indonesia expects that the provision of services for the community will be better because local governments better understand the needs of the people in their regions (Sutiyo & Maharjan, 2017). The provision of public services has very diverse types, while local governments have constraints on funding sources, so it is necessary to determine spending priorities. Indonesia's current condition still requires infrastructure development to meet the community's basic needs (Sukwika, 2018)the issue is interesting to be examined, especially the government is currently encouraging infrastructure development in various regions in Indonesia.This study aims at analyzing the dynamics of infrastructure and economic inequalities between regions (provinces. Therefore, local governments should prioritize spending allocations to fulfill basic services, usually allocated through capital expenditures.

Government spending allocations increase when there is an economic crisis because there is a tendency for people to know how the government provides stimulus to improve economic conditions (Bolívar et al., 2016). The economic crisis often causes the government to face unhealthy financial conditions due to revenue pressure and increased spending needs. Thus, financial health is a factor that influences local governments in allocating budgets, including in allocating capital expenditures that have an impact on infrastructure services.

Their efficient administration of financial resources evidences the fiscal soundness of local governments. When financially stable, local governments can efficiently distribute monies to address various public service requirements. Consequently, this can inspire local governments to augment their expenditure. Local governments are driven to improve transparency to ensure they are responsible for implementing budgets and maintaining solid financial stability. Therefore, as the financial conditions are more favorable, the impact of capital spending on financial performance becomes more pronounced.

H_3: The level of financial health strengthens the positive effect of capital expenditure on local government financial performance

Based on the theory of fiscal sustainability, regional government fiscal policies should pay attention to the impact on the next generation (Sinervo, 2020). Intergenerational justice guarantees are related to how the government maintains financial health and the type of investment and financing that the government is currently doing. This concept aligns with laws and regulations stipulating that loans obtained by local governments should be used to finance productive infrastructure or investment projects (Peraturan Pemerintah RI, 2019). Productive projects are expected to impact the community economically, such as generating income, reducing costs, or providing social benefits. In addition, healthy financial conditions reflect that local governments can manage resources well (Muhtar et al., 2018). With greater private investment, local government revenue from taxes and fees will increase. Increasing local tax revenues will encourage local governments to perform better.

Table 1. Research Sample

Criteria	Amount
Number of local governments on the website www.djpk.go.id as of May 2023	546
Total provincial government	(38)
The number of district/city governments that can be used in this study	508
Observation year (2016-2021)	6
Total local government-years	3048
Local governments without access to regional loans	(2417)
Outlier data	(1)
Total sample	630

Source: data processed

Fiscal decentralization was implemented in Indonesia to encourage local governments to generate revenue sources more independently. However, until now, many regional governments still depend on transfers from the central government for their source of income. This condition is considered that fiscal decentralization has not been able to encourage regional governments to produce local revenue sources. Financial conditions indicate the ability of local governments to manage their financial resources. Strong financial conditions mean local governments have sufficient revenues to cover their various expenses. Regional government spending will thus drive regional economic growth, increasing local revenue—greater regional own-source revenue results in better financial performance for local governments. Therefore, local governments with healthier financial conditions can reduce dependence on local governments so that local governments have better government financial performance.

H_4: The level of financial health weakens the negative effect of the level of dependence on local government financial performance

RESEARCH METHODS

This study employs a quantitative methodology to investigate the impact of independent variables on the dependent variable. Furthermore, this study employs analysis that relies on statistical test outcomes. This research employs a quantitative approach, utilizing secondary data from the financial records of district/city administrations across Indonesia. The research data was acquired from the website www.djpk.kemenkeu.go.id. The sample used in this study used purposive sampling with the summary as Table 1.

Local government financial performance is the dependent variable in this study. The proxy for local government financial performance (FP) follows the proxy used by Adinata & Efendi (2022) and Nauw & Riharjo (2021), namely (1):

$$FP = \frac{\text{Realization of Local Own Revenue}}{\text{(Central Government Transfers + Provincial Transfers + Regional Loans)}} \quad \ldots\ldots 1$$

Capital expenditure (CE), dependency level, and area size are the independent variables in this study. The capital expenditure proxy in this study follows the proxy used by Atmoko & Khairudin (2022), namely (2):

$$CE = \frac{\text{Capital Expenditure Realization}}{\text{Regional Expenditure Realization}} \quad \ldots\ldots 2$$

The level of regional dependence (DEP) follows the proxies (3) used by Adinata & Efendi (2022) and Setiani & Ismunawan (2022).

$$DEP = \frac{\text{Realization of balanced funds}}{\text{Realization of total local revenue}} \quad \ldots\ldots 3$$

This study includes financial health (FH) as a moderating variable. The financial health of local governments is a measure of their ability to carry out their responsibilities. This study measured financial health using the same proxy as Ritonga (2014). In indexing the financial situation of local governments, Ritonga (2014) included this ratio as a component of financial flexibility. First, financial health is calculated using the following formula (4):

$$FH = \frac{\text{(Total Revenue - Special Allocation Fund - Personnel Expenditures)}}{\text{(Loan Principal + Interest)}} \quad \ldots\ldots 4$$

The results of these calculations are then translated to obtain a financial health index with a range of 0 to 1 (5).

$$\text{FH Indeks} = \frac{\text{(Actual Value-Minimum Value)}}{\text{(Maximum Value-Minimum Value)}} \quad \text{.......5}$$

In this study, the natural logarithm of total assets at the end of the year is used as a proxy for the size of local government, following the proxy (6) used by Adinata & Efendi (2022).

$$\text{Size} = \ln \text{(Total Assets)} \quad \text{.......6}$$

Every year, BPK's audit opinion on Regional Government Financial Statements is used to assess the quality of regional financial reports. This dummy variable follows Adiputra et al. (2018) and Firmansyah et al. (2022). The acquisition of opinions other than WTP by the local government gets a score of 1, while the acquisition of opinions other than WTP gets a score of 0.

The hypothesis in this study was tested using multiple linear regression for cross-section data. The data collected from 2016 to 2021 is incomplete, with gaps in certain periods, leading this study to consider the data cross-sectional. Data for each entity was not consistently or fully collected for every year, meaning the time dimension typical in time series or panel data may not be fully represented. In this situation, the study treats the data as cross-sectional, where observations from various periods are viewed as separate points without considering the time sequence (Baltagi, 2005; Gujarati & Porter, 2009). Due to the missing data in certain periods, the analysis is conducted using a cross-sectional approach to simplify interpretation and address the issue of data completeness (Baltagi, 2005; Gujarati & Porter, 2009). Furthermore, the research model is as follows:

$$FP_i = \beta_0+\beta_1 CE_i+\beta_2 DEP_i+\beta_3 FH_i+\beta_4 CE^*FH_i+\beta_5 DEP^*FH_i+\beta_6 SIZE_i+\beta_7 FRQ_i+\varepsilon_i \quad \text{.......7}$$

FP_i is local government financial performance i in year t, CE_i is local government capital expenditure i in year t, DEP_i is local government dependency level i in year t, FH_i is local government health level i in year t, $SIZE_i$ is the size of local government i in year t, FRQ_i is quality of local government financial statements i in year t.

RESULTS AND DISCUSSIONS

Descriptive statistical data from all the variables used in this study are shown by Table 2. Furthermore, the results of the main hypothesis test after carrying out the classical assumption test are shown by Table 3.

The Association of Capital Expenditure and Local Government Financial Performance

Based on the hypothesis testing result, capital expenditure positively affects local government financial performance. The result of this test is in line with Digdowiseiso et al. (2022), Ramadana & Bahgia (2023), and Simamora & Budiwitjaksono (2022). The result of this test indicates that the provision of regional government capital expenditures supports the financial performance of local governments. Regional government capital expenditures are primarily intended for regional infrastructure, both those used in local government operations and services to the community.

Capital expenditure is crucial information for stakeholders, as it typically funds infrastructure projects that the community can directly benefit from and identify. According to stakeholder theory, local governments should involve various interests in regional programs and activities. Capital expenditure generally represents local governments' largest expenditure, so its information is closely tied to the accountability required from these governments. Stakeholders anticipate that local governments will execute quality capital expenditures and prioritize community needs as part of their role as public service providers (Nuryani & Firmansyah, 2020). While capital expenditure

Table 2. Descriptive statistics

Variable	Mean	Med.	Std. Dev.	Min.	Max.	Obs
FP	0.1539	0.1173	0.1391	0.0014	1.1434	630
CE	0.1998	0.1938	0.0688	0.0443	0.4782	630
CE_{t-1}	0.2102	0.2026	0.0722	0.0429	0.5583	630
CE_{t-2}	0.2193	0.2069	0.0707	0.0429	0.5583	630
DEP	0.6821	0.6919	0.0964	0.0028	0.8735	630
SIZE	28.6063	28.5305	0.5503	25.1891	31.2276	630
FPQ	0.8619	1	0.3453	0	1	630
FH	0.0109	5.11E-05	0.0645	0	1	630

Source: data processed

Table 3. The Summary of Hypothesis Test

Variable	Coeff.	T-Stat.	Prob.	
C	-0.648	-4.28	0	***
CE	0.111	3.356	0	***
DEP	-0.926	-29.802	0	***
KK	1.281	1.552	0.061	*
CE*FH	1.66	1.104	0.135	
DEP*FH	-2.318	-2.072	0.019	**
FPQ	0.024	4.143	0	***
SIZE	0.049	10.012	0	***
R^2	0.906			
Adj. R^2	0.903			
F-stat.	377.382			
Prob(F-stat.)	0			

Source: data processed

results in infrastructure that provides essential services to the community, it also helps local governments generate potential local revenue sources. This expenditure refers to the specific allocation of funds in a budget for acquiring long-term assets, including physical infrastructure or intangible assets with long-term value (Peraturan Pemerintah RI, 2010)

Capital expenditure is usually used for investment in infrastructure such as roads, bridges, and other public facilities. Infrastructure improvements can support economic growth in the region, improve the community's quality of life, and attract investment from the private sector so that the provision of infrastructure can increase regional income. Local government investment in capital expenditure projects is also considered to stimulate the local economy by creating new jobs, increasing community income, and supporting local businesses through demand for goods and services. In addition, capital expenditure on basic services to the community can improve the quality of public services. Better service quality can increase community satisfaction and support for the local government. Furthermore, better infrastructure can attract regional investment, so capital expenditure can indirectly increase regional income from taxes and levies.

The Association of Dependence Level and Local Government Financial Performance

The test of the hypothesis indicates that the dependence level on the local government negatively affects the local government's financial performance. The results of this test are in line with the findings from Adinata & Efendi (2022), Digdowiseiso et al. (2022), Firmansyah (2024), and Novita & Arza (2024). The finding of this study suggests that local governments reliant on central government payments consistently exhibit suboptimal financial performance.

High dependence on central government transfer funds often indicates that local governments have limitations in local revenue sources. This dependence can hinder the ability of local governments to develop more diverse and independent revenue sources. Central government transfer funds fluctuate based on national policies, budget changes, or macroeconomic conditions. This uncertainty can affect budget planning and implementation at the local level, which can have a negative impact on financial performance. When local governments rely too much on central government transfer funds, it can reduce the incentive to reform and improve local financial management. Dependence on central government transfer funds can lead to less efficient budget management. Local governments may be less motivated to plan and manage budgets effectively because of the guarantee of funds from the center, which can lead to waste or suboptimal use of funds. In addition, high dependence on transfer funds can make local governments very dependent on central government policies and decisions. It can limit regional flexibility in planning and implementing programs that are under local needs. When local governments rely on transfer funds, local governments may feel less responsible for managing resources effectively. This lack of accountability can have a negative impact on financial performance and the quality of public services. Although decentralization has been carried out for 20 years in Indonesia, its implementation may not be evenly distributed across regions (Puspita et al., 2021). Some regions may still have difficulty managing finances and utilizing regional autonomy effectively, so dependence on transfer funds remains high.

The Moderating Role of Financial Health in The Association Between Capital Expenditure and Local Government Financial Performance

The result of testing the hypothesis indicates that the financial health of local governments does not strengthen the positive effect of capital expenditure on local government financial performance. Financial health can be seen as the government's ability to deliver public services and obligations (Kooij & Groot, 2021). The financial health of local governments is related to the ability of local governments to obtain greater opportunities to gain creditors' trust in providing loans to local governments. It is expected that fiscal decentralization in Indonesia will improve the provision of services to the community because local governments better understand the needs of the people in their regions (Sutiyo & Maharjan, 2017). Capital expenditure is the expenditure that produces more infrastructure in an area. Infrastructure well managed by the local government can generate local sources of revenue. However, the health of local governments does not enhance the positive relationship between capital expenditure and local government financial performance.

Although the financial health of a local government may be generally good, certain aspects may still be weak. For example, if a local government is experiencing a liquidity shortage or has a high debt burden, good financial health cannot strengthen capital expenditure's positive effects. Good financial health does not always guarantee that human resources in local governments have sufficient capacity to plan, implement, and evaluate capital expenditure projects effectively.

The Moderating Role of Financial Health in The Association Between Dependency Level and Local Government Financial Performance

The result of testing the hypothesis indicates that financial health does not weaken the negative effect of the level of dependency of local governments on local government financial performance. The legislation stipulates that loans obtained by local governments should be used to finance productive infrastructure or investment projects (Peraturan Pemerintah RI, 2019). Productive projects are expected to impact the community economically, including generating revenue for the local government. In addition, healthy financial conditions reflect that local governments can manage resources well (Muhtar et al., 2018). With greater private investment, local government revenue from taxes and fees will increase.

High levels of dependence on transfer funds from the central government may be too large and significant, so good financial health is not enough to reduce the negative impact of such dependence. High dependence can create instability in budget planning and implementation that cannot be overcome by good financial health alone. Even though local governments have good financial health, local governments may experience problems in budget management and proper allocation of funds. The inability to manage dependence on transfer funds effectively can hinder the ability of financial health to improve financial performance. Good financial health does not always mean that the region has sufficient sources of revenue. If local revenue remains low, dependence on transfer funds will continue to have a negative impact on financial performance, and financial health cannot fully improve the condition.

CONCLUSIONS

This research has four conclusions. First, capital expenditure positively affects the local government's financial performance. Capital expenditure plays a significant role in supporting local government financial performance. Second, the dependency level negatively impacts local governments' financial performance. Local governments that still rely on regional revenue sources from central government transfers tend not to make optimal efforts to improve their financial performance. Third, financial health does not enhance the positive effect of capital expenditure on local government financial performance. Although a financially healthy government has confidence in managing its loans, this condition does not strengthen the positive relationship between capital expenditure and local government financial performance. Finally, financial health does not mitigate the negative impact of dependency on local government financial performance. A healthy local government does not guarantee a reduction in dependency, ultimately affecting the government's low financial performance.

This research has several limitations. First, the existence of certain criteria in the research sampling resulted in a significant reduction in the number of research samples. Second, the latest data used in the research is from 2021, considering that the Directorate General of Fiscal Balance has not yet issued the local government data for 2022. Future research can employ longer data to obtain more comprehensive test results. In addition, future research can issue criteria for local governments with loans to obtain more research samples. This research suggests increasing local government financial performance oversight to the Ministry of Home Affairs. In addition, the Indonesian Ministry of Home Affairs should monitor future fiscal decentralization related to regional governments' independence.

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