The Effect of Capital Cost and General Allocation Fund To The Regional Financial Independence in Bandung City Government

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Abstract. To measure the region in the field of finance performance, the level of Regional Financial Independence was used. Thelevel of Regional Financial Independence was indicated by the size of the Local Original Income when compared with regional income derived from other sources. Several areas in West Java Province have a phenomenon where local revenues increase but local financial independence decreases. The purpose of this study is to discover the quantity of Cost of Capital, General Allocation Fund and Level of Regional Financial Independence in Bandung City during the year 2010–2016. In addition to that, it is also meant to comprehend the effect of Cost of Capital and General Allocation Fund to the level of Regional Financial Independence both simultaneously or partially. The research method used was multiple regression analysis by comparing the research variables namely Cost of Capital and General Allocation Fund as independent variable with the Regional Financial Independence of Bandung city area as dependent variable. The results of this study signify that Cost of Capital and General Allocation Funds have a significant effect on the city government's Regional Financial Independence. It illustrates that Cost of Capital and General Allocation Fund are able to become predictor variable to improve Regional Financial Independence. Partially the Cost of Capital has a positive influence on the level of regional autonomy while the general allocation fund has a negative effect on the level of local financial independence.

Keyword. cost of capital; general allocation fund; financial independence level.

Article history. Received Agustus, 2018. Revised Oktober, 2018. Accepted December, 2018

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How to cite article. Hendawati, H., Komarasakti, D., and Ansori, S. (2018). The Effect of Capital Cost and General Allocation Fund To The Regional Financial Independence in Bandung City Government. *The International Journal of Business Review (The Jobs Review)*, *18*(2), 141–149. https://doi.org/https://doi.org/10.17509/tjr.v1i2.12934

INTRODUCTION

Regional financial independence can be seen from the amount of Local Own Revenue (LOR) obtained in a region. The larger the LOR compared to the assistance provided by the Central Government, then the region can be said to be independent. LOR itself is a major component in measuring the level of regional financial independence. Therefore, it is necessary to see the effectiveness of LOR by comparing LOR budgeted with its realization. If the LOR structure was strong, that the area could be considered has a strong financing capability.

While the Cost of Capital (CC) and General Allocation Fund (GAF) should only be supportive for the implementation of governance and regional development. The level of regional dependence on the central government in financing the area is smaller, then a region can be said to be independent.

Implementation of the administration of regency/municipality is one form of implementation of regional autonomy. The regional autonomy is reflected in the independent authority of each region, to manage the implementation of the government, to establish the structure of the regional administration apparatus, to prepare and realize the regional budget, and to arrange and apply internal control over the exercise of such authority (Law No. 32 of 2004 on Regional Autonomy).

The consequence of the implementation of regional autonomy is that each local government should be able to improve the service and welfare of society in a democratic, fair, equitable and sustainable manner. To meet these obligations, local governments must be able to manage the potential of the region in the form of natural resources, human resources to the potential of financial resources optimally. The ability of local governments in managing their finances is contained in the Regional Budget (RB), which reflects the ability of local governments to implement financial management as part of the government's administration. The role of the budget in the governmental administration, especially the local government, is intended to meet the public need for public facilities and infrastructure. In the context of local financial management, provision of public facilities related to Cost of Capital. Cost of Capitals according to FMD No: 91/PMK.06/2007 concerning Standard Account Charts define Cost of Capitals as budget expenditures which are used to acquire or add to fixed assets and other assets that provide benefits over one accounting period and exceed the minimum limit of fixed asset or other assets set by the government. Cost of Capitals are expenditures with benefits exceeding one fiscal year and will increase the assets or wealth of the region. So it can be concluded that Cost of Capital is a set of regional expenditures in this city government tangible assets are still intended to help smooth the implementation of government duties in order to help the provision of public needs and not to be traded. From the above explanation it is clear that the development of the region (city) can not be realized without any physical development in the form of facilities and infrastructure. Such physical building can be carried out if the planning is included in the RB at the Cost of Capital post. Cost of Capital allocation is formed through the process of budgeting.

According to Halim (2007), reliance on central aid is minimal, so that the original revenue is the largest source of financial support fully supported by central and regional fiscal policy. With the enactment of Law Number 22 Year 1999 concerning Local Government which was then revised by Law Number 33 Year 2004 regarding Regional Government, that is, regions are given wide autonomy or authority to manage their own households with the least possible interference of central government.

According to Dumairy (2009) states that in terms of income levels, there are significant differences between the regions in the country and during this time the inequality of economic activity or inter-regional development activities. General Allocation Fund is one component of expenditure on State Budget, and becomes one of the earning component in RB which is allocated with the purpose of equitable finance among regions to finance the needs of autonomous regions in the context of decentralization implementation.

Yustikasari (2007) stated that there is a positive and significant relationship between the GAF with Cost of Capital ie the higher than the Locally-Generated Revenue then the government's expenditure on Cost of Capital will be higher.

Furthermore Ardhani (2011) said that the higher the Locally-Generated Revenue the higher the realization of regional Cost of Capital budget. West Java Province in recent years, the proportion of GAF to regional revenues is still the highest compared to other regional revenues including Locally-Generated Revenue, so all that has happened is fiscal and subsidy dependence and central government assistance as a form of powerlessness of Locally-Generated Revenue in financing regional expenditure, especially on expenditure employees

Locally-Generated Revenue increased every year during the period 2010 to 2016. In 2010 the amount of Locally-Generated Revenue was Rp.441.863.068.294,00,00 and then reached Rp. 2.152.102.355.197,00 in 2016. General Allocation Fund (GAF) of Bandung City also experienced a significant increase from year to year during the same period. In 2010, the GAF Government of Bandung City amounted to Rp.912.571.834.000,00 and then reached up to Rp. 1.672.456.589.000,00 in the year 2016.

Similarly, the Cost of Capital (CC) of Bandung City also experienced a significant increase from year to year during the same period. In 2010, BM Government of Bandung City Rp. 405.699.482.843,00 and then reach up to Rp. 1.254.028.135.263,00 in the year 2016.

Certainly in the allocation of Cost of Capital as a supporter of the development process, the role of the budgeting process is very significant. The use of performance-based budgeting approach will of course be more influential in setting goals and outcomes until finally poured into the figures on the Cost of Capital of RB. Local revenue is revenue derived from local tax revenues, regional retributions, profits of regional companies, and others legitimate. From the above description the authors conclude that the original revenue area is all financial revenue of a region, where the financial revenue is sourced from the potentials in the area such as local taxes, levies and others, as well as financial revenue is governed by local regulations will be used to carry out the development and administration of government independently, fairly and equitably. Previous research has shown empirical evidence that Cost of Capitals are associated positively with maintenance spending and show that the associative relationship between Cost of Capital and maintenance is robust. Investments made by the local government in the form of Cost of Capital of 2 or 4 wheeled vehicles have a positive and significant impact on the original adoption of Bandung City. Cost of Capital has a significant positive influence on local financial independence, while general allocation funds have a significant negative effect on the level of local financial independence. The allocation of Cost of Capital has an effect on economic growth and economic growth indirectly influenced by regional performance. Cost of Capitals have a positive and significant effect on local income by using in Bandung City this indicates that this research concurred with previous research. Cost of Capitals negatively affect the growth of local financial performance directly, whereas indirectly Cost of Capital has a positive effect on the growth of financial performance through the original localization as intervening variable. This study shows different results with previous research. Some other researchers claim that there is an influence of local revenue and general allocation funds on Cost of Capitals. The results of these studies are mixed, some show a positive and negative relationship. This happens because of differences in variables, research samples, research periods, and research methods used. These differences encourage authors to strengthen evidence relating to the effect of Cost of Capital on the financial independence of local governments by using in Bandung City.

Literature Review and Hypothesis Development

Regional Finance

According to Article 1, paragraph 5 of PP. 58/2005 regional finance is generally defined as all regional rights and obligations in the conduct of local government which canbe assessed by money, including all forms of property related to the rights and obligations of the region. The scope of regional finance consists of directly administered regional finances and disaggregated wealth. Including directly administered regional finances are the Regional Budget (RB) and regional inventory items. Regional finances that are separated include Regional Owned Enterprises (ROE).

Local Financial Performance Indicators

According Musgrave (1980) there are 4 indicators of local financial performance Regional Financial Independence Level. Regional Financial Independence is the ability of the government to finance the government's own activities, development and services to the people who have paid taxes and levies as a source of income required area (Muliana, 2009). The purpose of regional financial independence reflects a form of local government whether or not it can perform its duties properly. According to Halim (2002) the independence ratio reflects regional dependence on external funding sources. The higher the self-reliance ratio, lower the reliance on external parties (especially the central and provincial governments).

Fiscal Needs

Fiscal needs can be interpreted as the cost of maintaining socio-economic infrastructure such as transportation, communication, educational institutions and health. Fiscal need variables are divided into population variables and territorial variables. Population variables include population numbers and relative poverty indices. Meanwhile, for regional variables include the area and extortionate index of buildings.

Fiscal Capacity

Fiscal capacity is the amount of tax that should be able to be collected from the tax base, which is usually a per capita income that is a component of the General Allocation Fund (GAF) calculation formula.

General Allocation Fund

Article 1 Paragraph 21 of Law No. 33/2004 states that the General Allocation Fund (GAF) is a fund sourced from State Budget which is allocated for the purpose of equitable inter-regional financial capacity to finance regional needs in the context of decentralization. From this definition,it can be concluded that GAF is a tool to overcome fiscal imbalances between regions as well as a source of regional financing. This means that GAF grants are prioritized in areas with low fiscal capacity. Areas that have high fiscal capacity will actually get smaller amounts of GAF, which is expected to reduce fiscal disparities (Adi, 2006).

Cost of Capital

According to Minister of Home Affairs Regulation no. 13 of 2006 article 53 Cost of Capitals are used for expenditures made in the framework of the purchase / procurement or construction of tangible fixed assets that have a benefit value of more than 12 (twelve) months for use in government activities, such as in the form of land, equipment and machinery, warehouse and buildings, roads, irrigation and other fixed assets and networks. The existence of Cost of Capital budgets sourced from central assistance and local own revenues has a strategic, as the target of its use is to finance the development in the field of facilities and infrastructure that can support the smoothness of business and fulfillment of public services.

Hypotheses Development

The government has two alternatives to the use of budget allocations, namely direct expenditures relating to government activities that are intended for the community in a variety of programming and indirect expenditures that are routine operational.

With regional autonomy, the regions are empowered to explore the financial resources in their respective regions so as to be able to finance their own regional expenditures consisting of operating expenditures (routine) and Cost of Capitals. The larger portion of the indirect budget allocation will be the smaller portion of budget allocation felt directly by the community (Hidayati and Yaya, 2013).

Ariani's research (2010), Rostina (2014) and Simatupang (2016) concluded that Cost of Capital has a positive influence on the level of regional autonomy if expenditure increases will increase the level of regional financial independence. The level of local financial independence is indicated by the contribution of Locally-Generated Revenue to finance regional expenditures including Cost of Capitals such as development and improvement in various sectors. The higher level of capital investment is expected to improve the quality of public services and in turn increase the level of public participation (contribution) to development as reflected by the increase in Locally-Generated Revenue (Mardiasmo, 2002). Central government transfers to local governments are a common phenomenon, especially in countries that implement fiscal decentralization. The transfer of funds in the short run serves to overcome the fiscal unpreparedness in various regional financing. Transferring is based on the fiscal capacity of the region, the higher the fiscal capacity of a region, the received transfer becomes lower. This policy on the one hand can overcome fiscal imbalances, but on the other hand it can cause local fiscal laziness (Adi, 2008).

Regions are not encouraged to increase their local potential, by increasing Locally Generated Revenue, as this may impact on the decrease in GAF revenues. Sivagnan and Naganathan (1999) conducted a study on the effect of central government transfers on tax efforts in India, the results of this study provide the empirical fact that the transfer of the funds actually give a negative influence on tax efforts which in turn reduce the revenue area so that the level of regional independence will also low.

Muliana's research (2009) and Ariani (2010) show that the General Allocation Fund has a negative effect on the level of regional financial independence, which means that if the GAF increases it will reduce the level of regional financial independence in other words the regional government's dependence on central government transfers becomes higher.

H1 : Cost of Capital has a positive effect on the level of regional financial independence

H2 : General Allocation Fund negatively affect the level of regional financial independence

RESEARCH METHOD

Research method used in this research is quantitative method. This research tries to reveal the big or small of an influence or relationship between variables expressed in figures, by collecting data that is a supporting factor to the influence between variables concerned, then try to be analyzed by using analysis tools in accordance with the variables in the study. Population and sample in this research is Locally-Generated Revenue in Bandung City. The observation period of the study was conducted from 2010-2016. The data used in this study is secondary data taken from the Bandung Local Revenue Report 2010-2016.

Variable Measurements

Regional Financial Independence Level

Regional financial independence is the government's ability to finance governmental activities, development and services to people who have paid taxes and levies as a necessary source of income (Muliana, 2009).

RFI =
LGRTLRR

RFI = Regional Financial Independence LGR = Locally Generated Revenue TLRR = Total Local Revenue Realization

Cost of Capital

Cost of Capital is the realization of all direct and indirect development expenditures. Cost of Capital = Ln Cost of Capital.

General Allocation Fund

General Allocation Fund (GAF) is a fund sourced from State Budget which is allocated for the purpose of equitable inter-regional financial capacity to finance regional needs in the decentralization context. General Allocation Fund = Ln General Allocation Fund

Data Analysis Method

Data obtained and used in this study will be processed using statistical methods with SPSS version 20.0 for windows to test the hypothesis and variables used. The data was processed by using multiple linear regression analysis. The method used to test the influence of independent variables to the dependent variable in this study was using Multiple Linear Regression. The multiple regression model in this hypothesis is as follows : $RFIL = \alpha + \beta 1CC + \beta 2GAF + \epsilon$

Notice :

RFIL = Regional Financial Independence Level
CC = Cost of Capital
GAF = General Allocation Fund α= constant

$\beta 1, \beta 2$ = regression coefficient ϵ = error term

RESULTS AND DISCUSSION

This research used population and sample of Locally-Generated Revenue of Bandung City period 2010 until 2016.

Classic Assumption Test

The results of the classic assumption test for normality (KS> 0.05), multicollinearity (tolerance> 0.10 and VIF <10), Autocorrelation test with DW values were between 2.433 <DW <(4 - 2.433) and heteroscedasticity with alpha> 0, 05. Based on the result of classical assumption test, it is found that this research has fulfilled the requirement of classical assumption test required.

Hypothesis Testing

Based on table 4-3 in the attachment shows the result of regression test with adjusted value of R^2 equal to 856 or 85,60%. This shows that 85.60% of the level of regional financial independence can be explained by the variable of Cost of Capital and General Allocation Fund.

The value of F obtained is 90.40. While the F_{table} value at the probability level of 0.05 is 3.09 with a probability of 0.009. Since F_{count} is greater than F_{table} and probability is much less than 0.05 then regression model can be used to predict the level of local financial independence or it can be said that the variable of Cost of Capital and General Allocation Fund together influence to the level of local financial independence.

Based on the test results in table 4-3 shows the sign of the coefficient of Cost of Capital is positive with a significance level of 0.009 <p-value of 0.05 indicates that Cost of Capital has a positive effect on the level of regional independence, then H1 accepted. A Regional Government with satisfactory quality of public services is always followed by high public participation (contribution) to development reflected by the high Locally-Generated Revenue.

Local governments use the Locally-Generated Revenue for their regional expenditures including Cost of Capitals. Cost of Capitals are then realized in regional development and regional improvement in various sectors. Thus Cost of Capital can affect the level of regional independence. In an effort to increase the level of regional financial independence, local governments are required to be able to optimize their revenue potential by providing larger portion of regional expenditure for productive sectors in development.

This shift in expenditure composition is aimed at increasing capital investment. The development of industrial infrastructure has had a marked impact on local tax increases (Wong, 2004). With the fulfillment of public facilities can encourage people to open business opportunities and can run their business so that ultimately can increase the revenue potential of local government.

This research is in line with research Wong (2004), Ariani (2010) Rostina and Simatupang (2016). Based on the test results in table 1 shows the sign of coefficient of General Allocation Fund is negative with a significance level of 0.009 <p-value of 0.05, indicating that general allocation funds negatively affect the level of independence, if general allocation funds increase or increase then will reduce the level of regional financial

independence. The granting of government transfers such as GAF should only be supportive for the implementation of government and regional development. Sarug and Sagbas (2002) found that in regions belonging to low-income regions, the transfer of income as a substitute for regional income was not a stimulus. When the stimulus effect is found, an increase in transfer allocation is followed by a well-established Locally-Generated Revenue potential. The smaller the GAF in supporting regional financing, it is expected that the dependence of local governments.

Table 1. Multiple Linear Regression Test Results

Independent Variabel	Reg Coef.	T	Sig	Description
1 (Constant)	8,692	9,328	0.001	
CC	,784	3.310	0.004	Significant
GAF	-,721	-3.740	0.002	Significant
F_{count}	18.894			Significant
p-value	009a			
Adjusted R^2	,856			

Source: data processed 2018

CONCLUSION

The results showed that Cost of Capital has a positive influence on the level of regional autonomy while the general allocation fund has a negative effect on the level of local financial independence.The results indicate that GAF should be used as a stimulus for local governments to increase the fiscal capacity of the regions, so that local governments are expected to be able to explore their own local income by increasing tax effort through local tax reform by eliminating unproductive taxes, provides a larger share of regional expenditure for productive sectors in development so that the source of local financing can be sustained by the Locally-Generated Revenue and less dependent on the balance fund provided by th central government. The subsequent researcher are expected to be able to increase the population/sample in their research, so that the result of this research can be used as the reference of appeal and can add another independent variable which is expected to influence the level of regional independence.

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