



An Empirical Analysis of Capital Expenditure, Government Size and Legislative Size on Local Government Financial Performance: Evidence from Indonesian Provinces

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Abstract: This research investigates the influence of capital expenditure, government size, and legislative size on the financial performance of Indonesian provincial governments from 2022 to 2024. Using a purposive sampling method, the study analyzed 34 provinces, (the four New Autonomous Regions formed as a result of the division of the Papua region namely South Papua, Central Papua, Highland Papua, and Southwest Papua are excluded from the research sample). intentionally excluding four newly formed autonomous regions to maintain data consistency. The empirical analysis was conducted via panel data regression using EViews. The results reveal that heightened capital expenditure has yet to be balanced by effective management, while asset size and legislative capacity do not serve as primary determinants of financial performance. To address the limitations of relying solely on secondary data, future studies should use the internal control system as a moderating variable and extend the longitudinal scope to capture long-term financial trends and qualitative dimensions such as integrity.

Keywords: Local Financial Performance; Capital Expenditure; Government Size; Legislative Size

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INTRODUCTION

Government Regulation No. 12 of 2019 on Regional Financial Management stipulates that local governments are obliged to provide regional financial information and make it publicly available to the public. This regional financial information serves to enhance transparency for the public and forms the basis for evaluating regional financial management. In practice, local government financial management must be carried out in an orderly manner and in compliance with laws and regulations as a form of accountability in public financial management. Issues relating to the financial performance of local governments remain a concern in public financial management. The Supreme Audit Agency of the Republic of Indonesia identified 7,845 instances of non-compliance during its audit of the 2023 Local Government Financial Reports (LKPD), comprising 5,883 cases with a financial impact of IDR3.49 trillion and 1,962 administrative irregularities. These findings indicate that local government financial management still faces various challenges, meaning that local financial

performance must continue to be evaluated to achieve more effective and accountable financial management.

Optimal local financial management is a crucial factor in achieving effective government financial performance and serves as a key indicator for assessing development progress and the quality of public governance (Periansya, et.al , 2021). Financial performance reflects the extent to which an entity is able to manage and utilise its budgetary resources efficiently and effectively in order to achieve its stated objectives (Yerriandha, 2025). In this context, local financial management is also linked to various aspects of local fiscal structures and policies, including the allocation of capital expenditure, the size of local government, and the extent of legislative involvement in the local budgeting and financial oversight processes.

Capital expenditure, which reflects the implementation of regional development, is a key component of the Regional Revenue and Expenditure Budget (APBD) and is expected to contribute to improving regional financial performance (Handayani, N & Dwigantara, 2020). Capital expenditure is generally allocated to the acquisition of fixed assets that provide long-term benefits, such as infrastructure development, public facilities, and the infrastructure and facilities supporting government services. Through adequate and well-planned allocation of capital expenditure, local governments can strengthen the capacity of local assets to support the performance of government functions and public services. The accumulation of assets resulting from such capital expenditure ultimately represents the extent of the resources held by local governments, which is then reflected in the size of the local government.

The size of government, which is generally measured in terms of asset value or budget size, can enhance fiscal capacity by enabling economies of scale and strengthening administrative capabilities (Antika, et.al., 2026). Larger local governments generally have more extensive resources to support the implementation of various government programmes and activities. Furthermore, the scale of these resources can also reflect the local government's capacity to manage and allocate budgets more comprehensively. Capital expenditure, which encompasses investment in infrastructure development, the provision of public services, and various community development programmes, is a strategic instrument for driving economic growth that leads to increased productivity, expanded employment opportunities, and social welfare (Harry et al., 2024).

In practice, the management and allocation of the local budget are also inextricably linked to the role of the local legislative body, which is responsible for budgeting and overseeing the local government's financial policies. This role is reflected in legislative indicators, which demonstrate the legislative body's institutional capacity to support the processes of local financial management and oversight.

Based on the above explanation, the author has conducted research into the financial performance of local governments, focusing on capital expenditure, the size of the government, and the size of the legislature.

LITERATURE REVIEW

Agency Theory

According to agency theory, there is a relationship between the principal and the agent, whereby the principal delegates decision-making authority to the agent to act in the principal's best interests (Jensen & Meckling, 1976). In the context of the public sector, the public acts as the principal, whilst the government acts as the agent mandated to manage regional resources

and finances. Consequently, the government is required to demonstrate sound financial performance as a form of accountability to the public for the management of public resources.

Financial Performance of Local Governments

Local government financial performance is a key factor in assessing government performance and serves as the basis for the management of government organizations to ensure accountability to the public (Anynda, N.S. & Hermanto, 2020). Local government financial performance is a measure of performance that uses local government financial indicators (Sartika, 2019). Good financial performance reflects the local government's ability to manage fiscal resources optimally, thereby enabling more adequate budget allocation for productive and effective capital expenditure (Harry et al., 2024). The financial performance of local governments can also be used as an indicator to assess the extent to which the government is able to provide high-quality public services to the community (Fauzi & Widarjo, 2021; Siregar et al., 2018). This study uses the Fiscal Decentralization Index to measure the financial performance of local governments. In this study, financial performance is defined as the ability of local governments to generate local revenue. The level of decentralization is used as a proxy variable to represent the financial performance of local governments, reflecting the authority of local governments to optimize revenue sources. This is measured using the ratio of total own-source revenue to total local revenue.

Capital Expenditure

Capital expenditure refers to budgetary expenditure allocated for the acquisition of fixed assets and other assets with a useful life spanning more than one accounting period (Ishak et al., 2021). Research from Sari, N.M.D.P & Mustanda (2019) shows that capital expenditure has a positive impact on the financial performance of local governments. Meanwhile, Zamzami, F. & Rahman (2023) in their research, they state that capital expenditure has a negative impact on financial performance. These differing findings suggest that the relationship between capital expenditure and the financial performance of local governments remains inconsistent, thus requiring further testing. Therefore, this study is important to conduct in order to provide additional empirical evidence regarding the relationship between capital expenditure and the financial performance of local governments.

Based on the theoretical framework and previous research, the following hypotheses have been formulated.

H1: capital expenditure affects the local government financial performance

Government Size

The size of a local government, as reflected in its total assets, has an impact on the level of its financial performance (Zamzami, F. & Rahman, 2023). A provincial government's scale is inherently mirrored in its asset base; thus, the total value of controlled and managed resources effectively quantifies the size of the respective local authority, whether it falls into the large or small category (Putri et al., 2025).

This study uses the natural logarithm (Ln) of total assets, as was done in the study by Mustikarini and Fitriasisi (2012); Sudarsana & Rahardjo (2013) and Putri et al. (2023). The use of this method is based on the fact that the differences in total asset values between local governments are quite substantial, which could potentially result in extreme values. To reduce

the likelihood of an abnormal data distribution, the total asset values are transformed into natural logarithms (Ln) (Sudarsana & Rahardjo, 2013).

Research findings from Zamzami, F. & Rahman (2023) shows that the size of local government has a positive influence on the level of local government financial performance. Research from Antika, et.al. (2026) it also states that the size of government significantly improves financial performance. The size of local government has a significant positive impact on the financial performance of local government (Putri et al., 2025). These two studies are at odds with the research by Sari, N.M.D.P & Mustanda (2019) which indicates that an expanded institutional asset base exerts an adverse influence on the entity's financial standing.

Based on the theoretical framework and previous research, the following hypothesis has been formulated.

H2: the size of local government affects local government financial performance

Legislative Size

The legislative size is derived from the number of members of the Regional People's Representative Council who act as budget overseers (Antika, et.al., 2026; Putri et al., 2023). Research findings from Antika et.al (2026) shows that the number of legislators has no significant impact on financial performance. This finding suggests that a larger number of legislators does not automatically enhance the effectiveness of fiscal oversight. The results of this study contrast with those of Putri et al. (2023) states that legislative size has a negative and significant effect on local government financial performance. The discrepancies in these research findings suggest that the relationship between legislative size and local government financial performance remains inconsistent. Therefore, this study is important to provide additional empirical evidence and to enrich the literature on the role of legislative size in the context of local government financial performance.

Based on the theoretical framework and previous research, the following hypotheses are formulated.

H3: legislative size affects local government financial performance

METHOD

The population in this study comprises all provincial governments in Indonesia. Sampling was conducted using purposive sampling, which involves purposive sampling based on specific criteria to the research objectives. The sampling criteria in this study are as follows:

1. Provincial governments in Indonesia that consistently published Local Government Financial Reports audited by the Supreme Audit Agency, along with related non-financial data, throughout the observation period from 2022 to 2024.
2. Provincial governments that have complete data for all study variable, including Capital Expenditures, Local Government Size (Total Assets Proxy), Legislative Size (Number of Provincial Legislator Members), and Financial Performance (Degree of Fiscal Decentralization Proxy).

Based on these criteria, out of a total of 38 provinces in Indonesia, four New Autonomous Regions resulting from the division of the Papua region (namely South Papua, Central Papua, Papua Mountains, and Southwest Papua) were excluded from the research sample. These four newly established provinces were excluded from the analysis due to the absence of continuous

and comprehensive historical data starting from the 2022 baseline. Consequently, the final eligible sample for this study comprises 34 provinces.

The type of data used in this study is quantitative panel data, comprising 34 provinces in Indonesia that fulfilled all specified selection parameters. The observation period spans three years, from 2022 to 2024. The analytical tool used in this study is Panel Data Regression employing the EViews statistical software. Panel data combines cross-sectional and time-series data. Estimation approaches in panel data models that account for heteroscedasticity and interdependence among cross sectional units can improve the efficiency of estimators and the quality of statistics (Bai & Liao, 2017). The research model can be formulated as follows:

$$LGFP_{it} = \beta_0 + \beta_1 CE_{it} + \beta_2 SIZE_{it} + \beta_3 LEG_{it} + \mu_i + \epsilon_{it}$$

Annotation:

$LGFP_{it}$: Local government financial performance of province i in year t

β_0 : Constant

$\beta_{1,2,3}$: Regression coefficients of each independent variable

CE_{it} : Capital expenditures of province i in year t

$SIZE_{it}$: Local government size (asset total) of province i in year t

LEG_{it} : Legislative size of province i in year t

μ_i : unobserved individual effect

$\epsilon_{i,t}$: error term

To determine the most fit model, we executed a sequential filtering mechanism across the Common, Fixed, and Random Effects frameworks to selected panel data model. The diagnostic process commenced with the Chow evaluation, immediately succeeded by the Hausman procedure to isolate the comparative validity of the FEM against the REM. Before examining the relationships between the fiscal predictors and the dependent construct, we mandated a series of classical assumption checks to ensure the chosen specification strictly adhered to the Best Linear Unbiased Estimator (BLUE) paradigms. To decide influence between variables, this research evaluated by examining p value and t statistic. Following this validation, the formal hypothesis evaluations were conducted to gauge the material impact of each independent variable. The resulting statistical evidence is subsequently detailed and contextualized in the following sections.

ANALYSIS AND DISCUSSION

The analysis was conducted to determine the effects of capital expenditure, government size, and legislative size on government financial performance as the dependent variable. The descriptive statistics table presents a summary of the data from the 102 observations used in the study, using raw values.

Table 1. Descriptive Statistics (n=102)

Variable	Minimum	Maximum	Mean
Capital Expenditure (IDR)	215,143,171,721	11,004,785,255,543	1,490,661,776,974
Government Size (total asset) (IDR)	2,390,427,662,103	745,956,336,004,049	38,995,397,042,222
Legislative size (number of members the provincial legislative council)	35	120	65
Government financial performance (ratios)	7.99 percent	73.55 percent	44.19 percent

Source: processed data, 2026

The table presents a summary of descriptive statistics from 102 research observations, indicating varying financial capacities among provinces in Indonesia. The capital expenditure variable has a minimum value of IDR215.14 billion and a maximum value of IDR11.00 trillion, with an average expenditure of IDR1.49 trillion. Similar differences are also evident in the local government size variable (total assets), where the smallest province's assets amount to IDR2.39 trillion, diverges significantly from to the province with the largest asset value at IDR745.95 trillion, with an overall average of IDR38.99 trillion. The extreme range of nominal values in both financial indicators serves as the basis for transforming the data into logarithmic form during the regression stage.

The legislative size variable, proxied by the number of provincial legislative members, exhibits a proportional data distribution. Regions characterized by minimal population size or limited capacity maintain a provincial council consisting of 35 members, while the highest number of legislative members is recorded at 120. Overall, among the 34 provinces observed during the study period, the average size of the regional legislative body stands at 65 legislative members per province.

Finally, regarding the dependent variable, government financial performance, the national average is 44.19 percent. These statistics suggest that, on an aggregate level, Indonesian provincial governments have yet to achieve full fiscal autonomy, as their operational financing remains inadequately supported by Local Own-Source Revenue. This observation is further evidenced by the substantial dispersion across the calculated financial ratio, indicating that some provinces remain heavily dependent on central government transfer funds, with the lowest ratio at 7.99 percent. Provinces proven to be self-reliant achieved the highest ratio of 73.55 percent.

To identify the optimal panel data regression model, the analysis commenced with the Chow test. This statistical procedure evaluates whether the Fixed Effects Model (FEM) provides a more robust estimation for the dataset compared to the Common Effects Model (CEM). Based on the data analysis results, the probability values for the Cross-section F-test and Cross-section Chi-square test were both < 0.05 . This indicates the presence of distinct characteristics or specific effects across the 34 provinces, leading to the conclusion that the FEM is the more robust estimation model compared to the CEM in this study.

Following the Chow test results, which demonstrated the superiority of the FEM over the CEM, the Hausman test was subsequently administered to adjudicate between the FEM and the Random Effects Model (REM). The null hypothesis (H_0) was that the REM is robust, and the alternative hypothesis (H_a) was that the FEM is robust.

Table 2. Random Effects Test – Hausman Test

	Output	Significance level (α)
Probability	0.044	0.05

Source: processed data, 2026

The Hausman diagnostic dictates the rejection of the null assumption, firmly establishing the FEM as the optimal analytical framework. From a public sector accounting perspective, the FEM rigorously isolates entity-specific budgetary behaviors and governance structures. Consequently, it provides a highly valid mechanism for examining how capital budgeting decisions, total asset accumulation, and legislative monitoring capacity influence regional fiscal independence. By controlling for the distinct accounting policies and institutional oversight environments inherent to each of the 34 provincial governments, the FEM ensures the reliability of the financial performance estimators

To address potential diagnostic anomalies, the selected Fixed Effects framework was processed incorporating the White Cross-Section methodology. This specific adjustment strategically recalibrates the standard errors associated with the fiscal predictors, effectively neutralizing underlying heteroscedasticity or cross-unit dependence. Consequently, the procedure guarantees that the subsequent hypothesis evaluations yield highly robust and unbiased accounting inferences.

Table 3. Coefficient of Determination

Statistic	Value
Adjusted R-squared	0,9810

Source: processed data, 2026

Evaluating the model's goodness-of-fit, the statistical output reveals an adjusted R-squared of 0.9810. Such a substantial coefficient implies that the combined effects of capital allocations, institutional asset base, and legislative size account for 98.10% of the variance in provincial financial performance across Indonesia. The negligible 1.90% remainder is driven by unobserved, exogenous factors excluded from this specific empirical design. Ultimately, this high predictive validity confirms that the hypothesized variables are integral to understanding local government financial performance.

Table 4. Partial Significance Test (t-test)

Variable	Coefficient	Prob. (p-value)
Capital Expenditure	-0,027164	0.0371
Government Size	0,005391	0.2145
Legislative Size	0,000515	0.1877

Source: processed data, 2026

The table shows that the Capital Expenditure variable has a coefficient of -0.027164 and a p-value of 0.0371. The primary hypothesis is empirically validated, as the significance level is under 0.05. The findings demonstrate a significant negative correlation, implying that increased capital expenditure systematically diminishes the financial performance of the provinces in terms of their fiscal decentralization capacity. The Government Size variable has a probability value of 0.2145. The statistical estimation for the government size parameter yields a p-value of 0.2145. Falling well above the 0.05 alpha criterion, this result leads to the rejection of the second hypothesis, This implying that Government Size does not have a significant effect on government financial performance. The total assets held by local governments are not a primary determining factor in improving government financial performance in terms of fiscal decentralization.

The Legislative Size variable has a probability value of 0.1877. Similarly, with a probability outcome exceeding the 0.05 criterion, the statistical evidence does not support the third hypothesis. This indicates that Legislative Size does not have a significant effect on government financial performance. The quantity of council members within a provincial legislature lacks the explanatory power to significantly alter governmental fiscal outcomes

Based on the statistical results, an F-statistic value of 146.0670 and a probability value of less than 0.001 indicate that, simultaneously, capital expenditure, government size, and legislative size have a significant effect on government financial performance.

The Effect of Capital Expenditures on Local Government Financial Performance

The test results indicate that capital expenditures have a negative effect on government financial performance. The probability value is $0.037 < 0.05$, and the coefficient is -0.027164. This aligns with the research by Zamzami, F. & Rahman (2023) which states that capital expenditure in the short term can have a temporary negative impact on financial performance because the project development process typically takes several years and due to fraud issues in the procurement of goods and services within the local government sector. This is also consistent with Silitonga, N., et.al. (2021), who state that aggressive capital expenditure inadvertently deteriorate the regional entity's financial standing Novita, et.al (2024) explains that the increase in capital expenditure has not been offset by local revenue, thereby negatively impacting government financial performance.

This finding is inconsistent with Mubarak et al., (2022), which explains that high capital expenditure allocation can help communities develop and access beneficial funding sources, thereby impacting local revenue. The aforementioned inconsistent findings are supported by Andhini et.al (2023), who state that increased strategic investments in capital assets play a pivotal role in strengthening regional fiscal self-reliance, which in turn enhances the overall financial standing of the local authority. Yerriandha et.al. (2026) explain that capital expenditure reflects the government's commitment to creating long-term public value that can improve the quality of public services, stimulate economic activity, and enhance overall welfare.

The Effect of Government Size on Local Government Financial Performance

Based on the empirical estimation, the scale of the government represented by its total asset base exhibits no material significance in determining the financial performance outcomes of the regional entity. The probability value of 0.2145 is greater than 0.05. The lack of an effect

of government size on financial performance suggests that the size of total assets managed does not guarantee efficiency in financial management. Consistent with the research by (Oktaviani, et.al., 2020) and (Rusmita, 2020), government size, proxied by total assets, does not have a significant impact on government financial performance.

This finding is inconsistent with some studies. Putri et al. (2025) concluded that any change in local government size, as measured by total assets, can impact financial performance. The total assets held by local governments influence financial performance by increasing government-owned fixed assets and investments in public facilities (Zamzami, F. & Rahman, 2023). Larger governments can manage resources and administrative structures more effectively, thereby gaining advantages in budgeting, revenue mobilization, and the delivery of public services (Antika, et.al, 2026).

The findings of this study reinforce the legal basis outlined in Ministry of Home Affairs Regulation No. 19 of 2016 on Guidelines for the Management of Local Government Assets, which states that financial performance efficiency is focused on the aspect of optimizing asset utilization. If assets are not managed productively to generate revenue, then a larger government size risks negatively impacting financial performance ratios.

The Effect of Legislative Size on Local Government Financial Performance

The analysis results indicate that legislative size has no effect on government financial performance. The probability value of 0.1877 is greater than 0.05. Consistent with the research (Antika, et.al. , 2026), the number of legislative members does not influence the exercise of oversight because effectiveness depends on competence, transparency, and institutional oversight. This research is supported by Hendaris & Sastradipraja (2024), which explains that local governments need to evaluate their legislative structures and seek strategies to enhance performance effectiveness without increasing the number of council members.

This finding is supported by Article 149 (1) of Law No. 23 of 2014 on Local Government, which states that the legislative oversight function is a collective institutional function in monitoring the implementation of the Regional Budget (APBD). The lack of significance of the number of members on financial performance reinforces the argument that oversight depends on substantive aspects and operational mechanisms.

This finding is inconsistent with research Putri et al. (2025), which highlights a negative influence due to conflicting interests between legislative members and the local government in fulfilling their obligations. Aswar (2019) states that the number of legislative members does not automatically guarantee improved financial performance of the local government.

CONCLUSION

This research emphasizes a critical gap in regional financial governance. Based on the certified Audit Board of the Republic of Indonesia records across 34 provincial entities (2022–2024), it is evident that maximizing economic potential requires more than just capital expenditure allocations, which currently exert an adverse effect on fiscal outcomes. The findings confirm that structural dimensions namely, the entity's asset base and legislative council size, lack the explanatory power to drive substantive improvements, suggesting that budget productivity is now more critical than simply increasing the entity's size.

Our testing proves that large capital expenditure decreases a region's fiscal independence ratio. In addition, the volume of government assets and the number of council members do not affect this financial measure. These findings match several past accounting papers, although previous studies still report mixed results. This study's contribution offers insights, particularly regarding the optimization of capital expenditures, the proper utilization of assets, and the legislative branch's role, especially in performance oversight. The study's findings indicate that.

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