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Tracking the Trail of Regional Financial Performance: Economic Growth as a Bridge towards Poverty Reduction

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ABSTRACT: This study aims to see and determine the indirect influence of regional government financial performance on poverty through economic growth in Indonesia. The analysis method used is multiple linear regression and Sobel test using secondary data from 34 provinces in Indonesia in 2014-2021. The findings of this study indicate that regional financial performance as proxied by the effectiveness ratio and efficiency ratio on poverty directly has an influence, but indirectly where economic growth which is an intermediary to see the influence of regional financial performance on poverty shows no influence, this shows that economic growth cannot mediate the influence of regional financial performance on poverty.

KEYWORDS: Regional Financial Performance, Economic Growth, Poverty, Effectiveness Ratio, Efficiency Ratio

INTRODUCTION

Indonesia is one of the developing countries that has rapid economic development. However, in the midst of this rapid economic development, there are still quite a number of poor people. In fact, many strategies and policies have been implemented by the Indonesian government to eradicate poverty from time to time.

The issue of poverty is one of the targets of development policies in every country so that the income gap becomes smaller. The poverty conditions of a country or region are also a reflection of the level of welfare of the population living in the country/region (Christianto, 2013). Indonesia is a country that is still classified as developing and poverty is a problem that is still a concern. (Zuhdiyaty and Kaluge, 2017). Poverty is one of the biggest challenges faced by governments in various regions.

The phenomenon from several countries shows that sustainable economic growth actually makes poverty worse due to inadequate consideration of poverty-related issues in various policies (Rakotovao and Bockel, 2001; Rougier, 2001). This is related to the government's ability to implement good and healthy governance and the government's accuracy in determining the right program for poverty alleviation.

Efforts to alleviate poverty often involve various policy aspects, one of which is regional financial management. The financial performance of local governments is an important factor in providing effective public services, infrastructure, and welfare programs to improve the quality of life of the poor. However, the direct relationship between financial performance and poverty reduction is not always clearly visible. Regional economic growth has the potential to be an important variable that bridges the influence of financial performance on poverty reduction.

Economic growth is expected to be able to create more jobs, increase community income, and encourage investment in various sectors that will ultimately have an impact on reducing poverty rates. In this case, the role of government is vital in managing the budget well, so that it can encourage inclusive economic growth. Solid financial performance allows local governments to maximize spending that has an impact on key sectors such as infrastructure, education, and health that contribute to economic growth.

The theory of public financial management emphasizes the importance of efficiency and effectiveness in the use of resources by the government. Good financial performance should be able to support economic growth and community welfare. However, this theory often only highlights the macro aspects of budget management without explicitly examining its ultimate impact on poverty.

Not all regions with good financial performance have succeeded in reducing poverty rates. The results of Hamzah's (2008) research explain that there are differences in financial performance in each different region. Halim (2002) found that the Regional Government (Pemda) of Regency/City in Java-Bali has different financial capabilities from the Regional Government of

Regency/City outside Java-Bali. The difference in performance is caused by differences in the ability of each region to increase local income potential. Therefore, automatically there are differences in the ability that occur between one region and another in increasing their economic growth which will ultimately have an impact on reducing poverty. Research conducted by Hamzah (2008), Sularso and Restianto (2011), Dwirandra (2014), Syamsudin et al. (2015), Astuti (2015), Sari et al. (2019), Yuana (2014), Widodo (2014), Wijaya (2013) and Berliani and Riduwan (2017) show that financial performance affects economic growth. Meanwhile, the research results from Siregar and Wahyuniarti (2007), Smida (2013) in Fatoni et al. (2019), Supartoyo et al. (2013) and Chatami (2014) show inconsistent results. Several studies that discuss the influence of regional financial performance on poverty through economic growth show inconsistent results. Such as research conducted by Musgrave & Musgrave (1989), Barro (1991), Todaro & Smith (2015), Gounder (2001), Burnside & Dollar (2000) whose results show that economic growth can mediate regional financial performance on poverty. Meanwhile, the results of Ravallion (2001), Piketty (2014), Dollar & Kraay (2002), Easterly (1999), Rodrik (2000) show that uneven or non-inclusive economic growth is often unable to bring direct benefits to the poor. Therefore, an analysis of how economic growth functions as a mediator in the relationship between regional financial performance and poverty levels is important to conduct.

Through this study, it will be analyzed how regional government financial performance can indirectly affect poverty through economic growth. A deeper understanding of this mechanism will help policymakers to design more effective financial strategies in reducing poverty, with a focus on increasing inclusive and sustainable economic growth. 34 provinces in Indonesia are the focus of this study, considering the complexity of the challenges faced in managing regional finances amidst efforts to increase economic growth and reduce poverty.

LITERATURE REVIEW

Poverty theory explains poverty as a multidimensional phenomenon that is not only related to income, but also to access to education, health, housing, and other social services. This theory views poverty as the result of various factors, including economic inability, social marginalization, and unequal distribution of resources. One widely known approach is Amartya Sen's capability theory, which emphasizes the importance of expanding individuals' capabilities to choose a life that they value. The role of government is very important in providing access to public services and creating conditions that allow people to develop their capabilities through effective budget management.

Classical economic growth theory, such as that proposed by Adam Smith and David Ricardo, emphasizes the importance of capital accumulation, labor, and productivity as the main factors influencing growth. Meanwhile, modern theories such as endogenous growth theory highlight the importance of investment in infrastructure, education, technology, and the role of government in creating an environment that supports innovation and economic efficiency (Romer, 1990).

In the regional context, economic growth driven by public investment can create jobs and increase people's incomes. Local governments that have good financial performance can allocate resources appropriately to support productive economic sectors, which in turn increases community income and reduces poverty.

Endogenous growth theory emphasizes the importance of government policies in driving economic growth. This theory also emphasizes internal factors, such as technological innovation, quality of human resources, and infrastructure as drivers of economic growth (Xiang et al., 2024). In the research of Putra et al. (2023) the use of technology has a positive impact on decision making in marketing, economics and market predictions. The results of this study are in line with the theory of endogenous growth which shows that technology will ultimately support sustainable economic growth.

The theory of local government financial performance reflects the government's ability to manage the budget effectively and efficiently to achieve development goals, including reducing poverty and improving community welfare. According to the theory of public financial management, the quality of financial performance can be measured from various aspects, such as budget efficiency, the ratio of local revenue (PAD), and budget allocation for priority programs that support economic and social development. Good financial management is believed to be able to maximize the use of regional resources to support economic growth and improve community welfare. Research by Putra et al. (2024) in Melawi Regency, identified the extent to which internal resource development can strengthen the industrial sector and support sustainable economic growth. Based on the theories above, it can be understood that good local government financial performance has the potential to drive economic growth through investment in important sectors such as infrastructure, education, and health. However, economic growth does not always have a direct impact on poverty reduction, especially if the growth is not inclusive or uneven. Therefore, economic growth is often seen as an intermediary variable in the relationship between financial performance and poverty.

According to the theory of inclusive growth, the benefits of economic growth must be enjoyed by all levels of society, including the poor, in order to have a significant impact on poverty reduction. Inclusive economic growth can be achieved through fair distribution of development results, creation of quality jobs, and effective income redistribution policies. Local governments

that are able to manage their budgets well tend to be better able to facilitate inclusive economic growth, thereby strengthening the relationship between financial performance and poverty reduction.

Local governments that have good financial performance can direct their investments to sectors that drive economic growth, such as infrastructure development and improving public services. The resulting economic growth is then expected to create jobs, increase income, and ultimately reduce poverty levels in the area.

It is important to provide a basis for more effective policy making. Theories of public financial management and economic growth can be used to formulate more targeted policies in poverty alleviation. Without a clear understanding of the mechanism of the influence of financial performance on poverty through economic growth, fiscal and budget policies made by local governments may not be optimal. This study provides a theoretical contribution by clarifying how good budget allocation, if supported by economic growth, can effectively reduce poverty.

METHOD

This research is included in quantitative research and was conducted in 34 provinces in Indonesia in 2014-2021 (8 years). The data used in this study are secondary data obtained from the website of the Central Statistics Agency (BPS). The variables in this study are regional financial performance as an independent variable proxied by the effectiveness ratio as X1 and the efficiency ratio as X2, poverty as a dependent variable (Y) and economic growth as an intermediate variable (Z). The analysis technique used in this study is multiple linear regression to see the influence between variables and the Sobel test to see the financial performance of local governments as independent variables can indirectly affect poverty as a dependent variable through economic growth as a moderating variable.

RESULTS AND DISCUSSION

This study uses descriptive statistical analysis to describe the condition of the research sample and also to facilitate understanding of the data used in this study. Descriptive statistics are obtained from the average value, standard deviation, maximum value and minimum value of various variables used in the study.

Table 1. Descriptive Statistics

Variables	Mean	Std. Deviation
Effectiveness Ratio	0,99	0,12
Efficiency Ratio	1,02	0,75
Economic Growth	4,37	3,29
Poverty	10,19	4,64

Source: Processed Data, 2024

Based on Table 1, it shows that the regional financial performance variable in 34 provinces in Indonesia in 2014-2021 shows an average effectiveness ratio of 0.99, meaning that local governments in Indonesia only achieved 99% of the planned revenue or expenditure targets, indicating that local governments failed to achieve the set revenue targets. This may indicate problems in revenue collection, resource management, or suboptimal planning. However, with a standard deviation of 0.12, it shows that almost all provinces in Indonesia have achieved revenue or expenditure targets to support government activities. Meanwhile, the efficiency ratio is 1.02, meaning that the expenditure incurred exceeds the income generated. This indicates that financial management is inefficient, because the government spends more funds than it earns, which can lead to a deficit or waste of the budget. Local governments use the available budget to run their programs. A good efficiency ratio shows that the government can maximize results at minimal cost. The average economic growth variable in Indonesia of 4.37 shows a fairly good growth trend, but the standard deviation of 3.29 indicates significant fluctuations. This means that Indonesia's economic growth is not always stable and can be influenced by external or internal factors such as policy changes, global situations, or domestic conditions. Meanwhile, the average poverty in Indonesia in 2014-2021 of 10.19 shows a fairly significant poverty rate, but the standard deviation of 4.64 indicates fluctuations or instability in the poverty rate over time. There are years where poverty can increase sharply or decrease significantly. Given the unstable poverty rate, responsive social and economic policies are needed to maintain people's welfare and prevent spikes in poverty in certain years.

Table 2. Regression Results

Description	Coefficient Value	Sig	Results
Structural Equation 1			
Effectiveness Ratio => Economic Growth	-0,160	0,031	Influential
Efficiency Ratio => Economic Growth	0,221	0,003	Influential
Structural Equation 2			
Effectiveness Ratio => Poverty	-0,324	0,000	Influential
Efficiency Ratio => Poverty	0,145	0,042	Influential
Economic Growth => Poverty	0,081	0,188	Not Influential

Source: Processed Data, 2024

Based on Table 2, the regression equation that describes the effect of the independent variable on the moderating variable in equation 1 and the effect of the independent variable on the dependent variable through the moderating variable is as follows:

Structural Equation 1

Economic Growth = -0.160 Effectiveness Ratio + 0.221 Efficiency Ratio + e

The coefficient -0.160 shows that every 1 unit increase in the effectiveness ratio assuming a fixed efficiency ratio will cause a decrease in economic growth of 0.160 units. This negative coefficient shows that there is a negative relationship between the effectiveness ratio and economic growth. This means that if the effectiveness ratio increases (for example, the government succeeds in realizing more revenue than the target), it will actually be followed by a decrease in economic growth. This happens if the realized revenue is not fully invested in productive activities or there is waste in budget allocation. An increase in realized revenue compared to the target (high effectiveness ratio) does not always contribute to increased economic growth, perhaps because the revenue is not used efficiently or the budget allocation is not productive. Meanwhile, the efficiency ratio coefficient of 0.221 shows that every 1 increase in the efficiency ratio assuming a fixed effectiveness ratio will cause an increase in economic growth of 0.221 units. This positive coefficient shows that there is a positive relationship between the efficiency ratio and economic growth. This means that the more efficient the government is in using the budget (the lower the efficiency ratio), the more positive impact it will have on economic growth. In other words, the better the government utilizes the existing budget, the greater the economic growth generated, the more efficient the government is in managing the budget (by reducing waste), the greater the impact on economic growth.

Structural Equation 2

Poverty = -0.324 Effectiveness Ratio + 0.145 Efficiency Ratio + 0.081 Economic Growth + e

The coefficient of the effectiveness ratio shows that every 1 increase in the Effectiveness Ratio assuming a fixed efficiency ratio and economic growth will cause a decrease in the poverty rate of 0.324. This means that better revenue management tends to contribute to poverty reduction, possibly because more funds are realized that can be used for social or development programs that have a positive impact on poverty reduction.

Furthermore, the efficiency ratio coefficient shows that every 1 increase in the efficiency ratio assuming the effectiveness ratio and economic growth remain the same, will cause an increase in the poverty rate of 0.145. This positive relationship shows that the more efficient the government is in managing the budget (low efficiency ratio), the lower the poverty rate. However, the positive relationship in this equation means that an increase in the efficiency ratio is less efficient and tends to increase poverty. This means that if the government is not efficient in using the budget, funds that should be used to reduce poverty are not optimally absorbed and poverty increases.

Meanwhile, the economic growth coefficient shows that every 1 increase in Economic Growth (assuming the effectiveness ratio and efficiency ratio remain the same), will cause an increase in the poverty rate of 0.081. This positive relationship with economic growth is somewhat unusual because usually higher economic growth is expected to reduce poverty. However, in this equation, higher economic growth is actually associated with increased poverty, which may indicate non-inclusive economic growth. In some cases, economic growth is only enjoyed by a handful of groups or sectors, while vulnerable groups remain trapped in poverty.

Based on the two structural equations above, it shows that economic growth is not fully able to mediate the relationship between financial performance (effectiveness and efficiency ratios) and poverty. Although financial performance affects economic growth, the effect of economic growth on poverty is not significant or even contradictory (positive), indicating that increasing economic growth does not always reduce poverty. This result is supported by the Sobel test which aims to see the effect of local government financial performance on poverty through economic growth as seen in Table 3.

Table 3. Results of the Test of the Indirect Effect of Regional Financial Performance on Poverty Through Economic Growth

Description	Coefficient	Standard Error	$t_{statistic}$	t_{table}	Prob.	Result
Effectiveness Ratio => Poverty Through Economic Growth						
Effectiveness Ratio	-0,160	1,965	-0,081	1,96	0,935	not mediate
Economic Growth	0,081	0,087				
Efficiency Ratio => Poverty Through Economic Growth						
Efficiency Ratio	0,221	0,323	0,551	1,96	0,581	not mediate
Economic Growth	0,081	0,087				

Source: Processed Data, 2024

The results of the Sobel test show a probability value of more than 0.05 and the calculated t value is smaller than the t table, meaning that the results of this study indicate that economic growth is unable to mediate the relationship between financial performance and poverty. This suggests that good financial performance may have a direct impact on poverty alleviation through budget allocations for social welfare programs, education, health, and empowerment of the poor, without having to go through economic growth. The results of this study are supported by research by Ravallion (2001), Piketty (2014), Dollar & Kraay (2002), Easterly (1999), Rodrik (2000).

In this case, regions that have solid financial performance are able to directly target sectors related to improving the standard of living of the poor. For example, capital expenditures directed to free health services, education, and social assistance can directly help reduce poverty without having to rely on economic growth as a link. This indicates that increasing the capabilities of the poor may be more important in reducing poverty than just economic growth.

When economic growth fails to mediate the effect of financial performance on poverty, there are several potential explanations that can be raised. First, it could be that the economic growth that occurs in the area is not inclusive or even. High economic growth may only benefit certain groups, especially the upper middle class, without significantly reducing poverty among the poor. This shows that non-inclusive economic growth will not have a significant impact on reducing poverty levels.

Second, the distribution of benefits from economic growth may not be directed to the poor. Economic growth may be concentrated in certain sectors that do not absorb labor from the poor, thus not reducing poverty significantly. This confirms that high economic growth does not automatically have an impact on the welfare of all groups in society, especially if the growth is more based on capital-intensive industries than labor-intensive ones.

Good financial performance allows local governments to directly direct the budget to programs that are fundamental to the welfare of the poor. For example, poverty alleviation programs based on social assistance or local community empowerment can directly reduce poverty without having to rely on economic growth. In this context, the financial performance of local governments plays a significant role in designing and implementing policies that directly target the poor.

In addition, local governments may use budget surpluses to improve access to education and health for the poor, which directly impacts on improving the quality of life and reducing poverty rates. Therefore, the main focus of local governments may not be on driving overall economic growth, but rather on allocating more targeted budgets for social programs.

These results have important policy implications. Local governments may need to focus more on how efficient budget allocation can directly impact poverty reduction, without having to go through economic growth as an intermediary. Policies that target the poor, such as direct cash assistance, subsidy programs, or improving basic services (health and education), may be more effective strategies than focusing on increasing overall economic growth. In addition, these findings emphasize the importance of further evaluating the quality of economic growth that occurs in a region. Although economic growth is often seen as an indicator of progress, the results of this study indicate that if the growth is not inclusive and does not touch the poor, then its impact on poverty will be minimal.

This finding is different from several previous studies such as Musgrave & Musgrave (1989), Barro (1990), Todaro & Smith (2015), Gounder (2001), Burnside & Dollar (2000) which show that economic growth often acts as an important mediator between financial performance and poverty. In this context, the results of the study provide evidence that economic growth does not always act as a mediating variable in all conditions or regions. Several studies have shown that regions with high income inequality often do not feel the impact of poverty reduction, even though the level of economic growth is high.

This finding also supports the literature highlighting that uneven economic growth often fails to reduce poverty levels. This suggests that the focus of local governments should be more on the distribution of benefits rather than simply pursuing economic growth.

The results of this study confirm that although economic growth is often seen as the main indicator in reducing poverty, this study shows that without equitable distribution or the right policy focus, economic growth is not always the solution to poverty reduction. Local governments need to focus more on efficient budget management and programs that directly target the poor.

CONCLUSION

The findings of this study indicate that regional financial performance has a direct effect on poverty without economic growth as a mediator and economic growth has no direct effect on poverty. Further results show that economic growth is unable to mediate regional financial performance on poverty, these results are supported by the Sobel test that has been conducted.

This study has limitations, one of which is that this study does not consider all aspects of economic growth that can affect poverty, such as income distribution, differences in economic sectors, and levels of social inequality. In addition, this study is limited by a certain time span that does not fully reflect the long-term trend of the relationship between financial performance, economic growth, and poverty. Another limitation is that other social factors are not included as variables, such as education level or quality of health services, which may play a greater role in influencing this relationship but have not been fully taken into account in the model used.

Future research should further examine why economic growth in some regions is unable to mediate the relationship between financial performance and poverty, by making factors such as social inequality, income distribution, and types of economic growth variables so that they need to be analyzed in more depth to understand why economic growth does not have a significant mediating effect. Further research could expand the analysis by including other variables that may influence poverty, such as investment in human capital, the quality of public services, or the influence of income redistribution policies.

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