EFECTS OF LOCAL OWN-SOURCE REVENUE (PAD) AND CAPITAL EXPENDITURE ON REGIONAL ECONOMIC GROWTH

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Abstract

This research examined the direct and indirect effects of local own-source revenue (PAD) and capital expenditure on regional economic growth, with regional financial performance serving as a mediating variable in the former Pati Residency area of Central Java. This research analyzed two decades of panel data (2005–2024) from five regencies. The researchers applied path analysis using a random-effects model and test mediation with the Sobel test. The results reveal that PAD positively affects regional financial performance, whereas capital expenditure does not. The findings also indicate that PAD, capital expenditure, and regional financial performance do not affect regional economic growth. In addition, regional financial performance does not mediate the effects of PAD and capital expenditure on economic growth. These results imply that increasing regional fiscal capacity does not automatically drive real economic growth; therefore, policymakers need a more integrated approach that aligns budget planning with economic development strategies based on local leading sectors.

Keywords: PAD, Capital Expenditure, Financial Performance, Regional Economic Growth, Mediating Variable

INTRODUCTION

Regional autonomy, as mandated by Law No. 23 of 2014, grants local governments broad authority to manage governmental affairs and public interests independently (Musyarofah & Indarti, 2014). In the former Pati Residency area, this autonomy was expected to foster fiscal independence and stimulate regional economic growth through the optimization of local resources. However, empirical conditions reveal a paradox of autonomy: these regions still show a high dependence on central government transfer funds. This dependence not only weakens the effectiveness of local own-source revenue (PAD) as an indicator of fiscal independence but also risks distorting the role of capital expenditure in stimulating the regional economy.

Theoretically, resource dependence theory (RDT) explains this condition, as strengthening PAD and allocating capital expenditure constitute crucial strategies for reducing reliance on external resources. In addition, stakeholder theory views capital expenditure investment as having broad impacts on public welfare and overall regional financial performance. Accordingly, infrastructure-oriented capital expenditure is expected to generate a multiplier effect on economic growth (Tampi, 2021). PAD also plays a central role in the concept of local self-government, where local revenue contributions serve as the primary engine of development (Riswandi, 2024).

Although many studies have examined the importance of PAD and capital expenditure for financial performance and economic growth, prior findings remain inconsistent. Several studies report a positive effect of PAD on financial performance (Atmoko, 2022); (Ardelia, 2022), whereas (Alfayed, 2025) finds no significant effect. Similar contradictions appear in studies on capital expenditure: (Mubarok & et. al., 2022); (Lathifa & Haryanto, 2019) find a significant effect on financial performance, while (Atmoko, 2022); (Ardelia, 2022) report the opposite. Other studies indicate that capital expenditure significantly affects economic growth (Winarto & Indarti, 2024); (Alfayed, 2025). These inconsistent findings suggest the possible presence of an intervening variable that mediates these relationships.

This study investigates the causal relationships among local own-source revenue (PAD), capital expenditure (BM), financial performance, and regional economic growth. The study's originality resides in examining financial performance as a mediating variable that synthesizes the impacts of PAD and BM on the enhancement of regional economic growth. The analysis uses two decades of longitudinal data (2005–2024) to provide a comprehensive view of long-term fiscal dynamics. Theoretically, this study contributes to the public financial management literature. We expect the practical implications of the findings to guide local authorities in crafting strategic fiscal policies that enhance financial performance and foster sustainable economic growth.

REVIEW OF LITERATURE

Resource Dependence Theory

Resource dependence theory (RDT), by Pfeffer and Salancik (1978), posits that organizational survival and goal attainment—including those of local governments—heavily rely on the management of reliance skills on external resources. This dependence significantly shapes decision-making mechanisms, budget allocation patterns, and strategic interactions with external stakeholders to mitigate environmental uncertainty (Indarti & et.

al., 2024). Furthermore, (Hillman, 2009) emphasizes that although external pressures influence organizational behavior, management can reduce such dependence by controlling strategic resources that are critical to organizational sustainability.

Stakeholder Theory

Stakeholder theory defines organizations as networks of associations composed of individuals and groups that collaborate to achieve collective goals. These networks encompass a wide range of actors, including employees, suppliers, and customers, as well as governments, labor unions, political groups, and even competitors. Therefore, efforts to integrate stakeholders require organizations to create collaborative relationships based on trust, especially with non-economic stakeholders like regulators, environmental organizations, and local communities (Sharma & Vredenburg, 1998). Because each stakeholder can contribute to organizational success or failure, management must ensure a fair distribution of benefits to sustain these relationships (Indarti & et. al., 2024).

Effects of Local Own-Source Revenue (PAD) on Financial Performance of Regional Government

Local own-source revenue (PAD) represents regional fiscal independence and derives from local taxes, levies, and returns on the management of other regional assets, as mandated by Law No. 33 of 2004. Strategically, PAD is a tool for accelerating economic growth based on local potential and making the region's finances more stable (Carunia, 2017). This theory suggests that increasing PAD reflects stronger fiscal capacity. Eventually, this situation enables local governments to meet public expectations through more accountable services, thereby improving financial performance (Ardelia, 2022). Consistent with RDT, strengthening PAD allows regions to reduce dependence on central government transfer funds and grants greater managerial flexibility in independently managing internal resources.

Empirical evidence supports this relationship. (Atmoko, 2022) and (Ardelia, 2022) demonstrate that significant contributions from local economic potential positively influence regional financial performance. A high PAD not only indicates local economic capacity but also acts as a crucial predictor of a robust and stable financial governance cycle. Based on this theoretical review and empirical findings, this study presents the following hypothesis:

H1: Local-own revenue (PAD) positively influences financial performance of regional government.

Effects of Capital Expenditure on Financial Performance of Regional Government

Capital expenditure refers to budgetary spending for the acquisition or expansion of fixed assets that generate economic benefits beyond one accounting period and meet the minimum capitalization criteria (PMK No. 62 of 2023). Capital expenditure, a subset of direct expenditure, is a strategic investment meant to improve long-term resources, like technology and infrastructure, to facilitate efficient public service delivery.

From a theoretical perspective, stakeholder theory views capital expenditure allocation as an expression of local governments' responsibility to the public by transforming budgets into productive, transparent, and accountable assets. In addition, resource dependence theory (RDT) explains that capital expenditure functions as a strategy to strengthen the internal resource base and stimulate local economic activity, which in turn enhances fiscal independence and reduces reliance on central government transfer funds (Pirade, 2018); (Sularso & Restianto, 2012).

The effectiveness of capital expenditure in improving financial performance depends heavily on sound planning and regional implementation capacity. Increasing assets through capital expenditure is assumed to correlate positively with financial performance because it supports service quality and future revenue potential. Empirical evidence supports this assumption. (Lathifa & Haryanto, 2019) and (Mubarok & et. al., 2022) reveal that capital expenditure significantly affects local government financial performance. Aligning capital expenditure optimization with the capacity of local own-source revenue (PAD) therefore serves as a crucial indicator for assessing the stability and quality of regional financial management. Based on this discussion, this study formulates the following hypothesis:

H2: Capital expenditure positively influences financial performance of regional government

Effects of Local Own-Source Revenue (PAD) on Financial Performance of Regional Government

Local own-source revenue (Pendapatan Asli Daerah/PAD) serves as a crucial fiscal instrument for accelerating regional economic growth. From the perspective of stakeholder theory, optimizing PAD provides local governments with the flexibility to implement strategic investments in physical and social infrastructure to meet public expectations. High-quality public facilities directly stimulate community productivity. This facilitation drives sustainable economic growth. Meanwhile, resource dependence theory (RDT) explains that strengthening PAD reduces fiscal dependence on the central government, thereby granting local authorities' greater autonomy to formulate economic policies that respond to their regions' unique potential (Saputra & et. al., 2023). This fiscal independence creates a business climate conducive to local economic expansion. Based on these arguments, this study proposes the following hypothesis:

H3: local own-source revenue positively influences regional economic growth

Effects of Capital Expenditure on Regional Economic Growth

Capital expenditure represents a strategic local government investment in productive assets and infrastructure that acts as a catalyst for regional economic growth. Under stakeholder theory, capital expenditure allocation reflects government responsibility to create an ecosystem that supports stakeholder welfare through the provision of high-quality public facilities. Adequate infrastructure development has proven to reduce logistics costs and accelerate private sector productivity (Winarto & Indarti, 2024). From the perspectives of resource dependence theory (RDT) and endogenous growth theory, investment in public capital stock improves the efficiency of local resource utilization and independently strengthens regional competitiveness. Consistently transforming budgets into productive fixed assets makes a tangible contribution to expanding regional economic scale (Alfayed, 2025). Based on these arguments, this study formulates the following hypothesis:

H4: capital expenditure positively influences regional economic growth

Effects of Financial Performance on Regional Economic Growth

Fiscal independence, efficiency, and budget effectiveness ratios within a given period measure the success of fiscal management in local government financial performance. From a stakeholder theory perspective, optimal financial performance reflects government accountability in transforming public funds into development programs that directly enhance public welfare (Dwirandra, 2020). Efficient financial management builds public trust and creates an investment-friendly climate that supports economic growth. In the context of resource dependence theory (RDT), elevated fiscal independence and decentralization ratios

signify a region's ability to manage its internal resources. This fiscal autonomy allows local governments to finance productive sectors independently and to accelerate local economic activity more flexibly. Empirical evidence supports this positive relationship. (Nisak, 2024) finds that financial efficiency significantly influences economic growth. Based on these arguments, this study proposes the following hypothesis:

H5: fincancial performance positively influences regional economic growth

Mediating Role of Financial Performance on the Correlation between Local Own-Source Revenue (PAD) and Capital Expenditure on Regional Economic Growth

The current study model uses financial performance as a mediating (intervening) variable that links regional fiscal capacity to macroeconomic outcomes. From the perspective of resource dependence theory (RDT), local own-source revenue (Pendapatan Asli Daerah/PAD) constitutes a strategic resource that requires effective financial governance to generate tangible economic impacts. Financial performance functions as a transformation mechanism that converts PAD potential into fiscal independence; in this context, high PAD accelerates economic growth only when governments manage it efficiently and effectively. Moreover, within the stakeholder theory framework, financial performance mediates the effect of capital expenditure on economic growth by ensuring that governments manage productive asset procurement professionally and in a targeted manner. By monitoring expenditure harmony ratios, financial performance ensures that infrastructure allocation goes beyond administrative compliance and creates multiplier effects for regional economic activity. Thus, the quality of financial performance determines the extent to which public investment transforms into a sustainable engine of economic growth. Based on this logic, the study proposes the following hypothesis:

H6: financial performance mediates local own-source revenue (PAD) on regional economic growth

H7: financial performance influences capital expenditure on regional economic growth

Figure 1 portrays the correlation effects among the variables in this research.

RESEARCH METHOD

The study population included all regency governments in the former Pati Residency, Central Java, comprising Kudus, Jepara, Pati, Rembang, and Blora Regencies. The study applied a census (saturated sampling) method to cover all population units over a 20-year observation period from 2005 to 2024. The study used secondary panel data that combined a cross-sectional dimension of five regencies with a 20-year time-series dimension, yielding a total of 100 observations.

The study used local own-source revenue (PAD) and capital expenditure (BM) as exogenous variables, regional economic growth (PER) as the endogenous variable, and financial performance (KK) as the mediating variable. Table 1 systematically presents the operational definitions and measurements of each variable.

Table 1.
Variable Measurements

Variabel	Measurments	References
PAD	Nominal PAD scores	(Indonesia, 2004)

BM	Capital expenditure ratio $BM\ Ratio\ = \frac{Local\ Own - Source\ Revenue}{Total\ Regional\ Expenditure} \times 1($	(Mahmudi, 2016)
KK	Ratio of fiscal decentralization level $DDF\ Ratio = \frac{Local\ Own - Source\ Revenue}{Total\ of\ Local\ Own - Source\ Rev} \times 100\%$	(Aminuddin & Winarningsih, 2024)
PER	PDRB Growth (%) $Economic\ Growth = \frac{PDB_t - PDB_{t-1}}{PDB_t} \times 100\%$	(BPS Kabupaten Kudus, 2025)

Source: processed data

This quantitative approach used panel data analysis and path analysis to test mediation effects based on the stepwise method developed by (Baron & Kenny, 1986). The current selected method matched the characteristics of the 20-year panel dataset. Panel data analysis is particularly suitable for testing the proposed mediation model because it provides more efficient, consistent, and unbiased estimates than separate cross-sectional or time-series analyses.

The current applied methodology had two empirical equation models.

$$KK = \beta_0 + \beta_1 PAD + \beta_2 BM + \varepsilon \ldots\ldots\ldots (1)$$

$$PER = \beta_0 + \beta_1 PAD + \beta_2 BM + \beta_3 KK + \varepsilon \ldots\ldots\ldots (2)$$

Model 1 investigates the impact of local own-source revenue (PAD) and capital expenditure (BM) on financial performance (KK). As a subsequent stage, Model 2 investigates the effects of PAD, capital expenditure, and financial performance on regional economic growth (PER). By integrating these two models, the study identifies both direct effects and the mediating role of financial performance in linking regional fiscal capacity to regional economic outcomes in a comprehensive manner.

Research Hypothesis

The hypothesis proposed in this study is as follows:

- H1: Local-own revenue (PAD) positively influences financial performance of regional government.
- H2: Capital expenditure positively influences financial performance of regional government
- H3: local own-source revenue positively influences regional economic growth
- H4: capital expenditure positively influences regional economic growth
- H5: fincancial performance positively influences regional economic growth
- H6: financial performance mediates local own-source revenue (PAD) on regional economic growth
- H7: financial performance influences capital expenditure on regional economic growth

Research Model

Figure 1 portrays the correlation effects among the variables in this research.

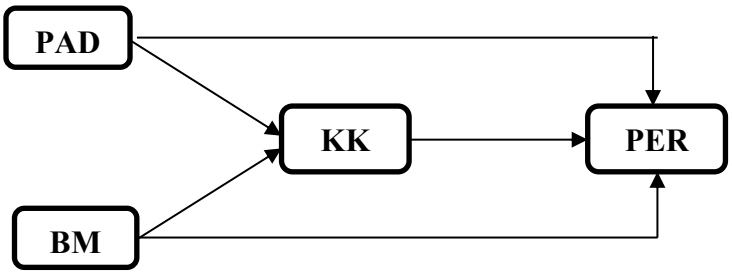

Figure 1.
Research Model

RESULTS AND DISCUSSION

Descriptive Statistics

Descriptive statistics provide an overview of the data distribution characteristics, including the mean, median, extreme values (minimum and maximum), and measures of dispersion. Tables 2 and 3 present the descriptive statistical summaries for all research variables.

Table 2.
Descriptive Statistics of Model 1

	KK	PAD	BM
Mean	13.89196	0.253699	0.260024
Median	14.17431	0.280000	0.240000
Maximum	25.62500	0.546000	0.678000
Minimum	5.809642	0.039000	0.051000
Std. Dev.	4.920766	0.144655	0.132359
Skewness	0.472396	-0.020253	0.491873
Kurtosis	2.605201	1.744665	2.818739
Jarque-Bera	3.626055	5.455546	3.460454
Probability	0.163159	0.065365	0.177244
Sum	1153.032	21.05700	21.58200
Sum Sq. Dev.	1985.543	1.715851	1.436558
Observations	83	83	83

Source: processed data

Table 2 presents the financial performance (KK) variable with a mean value of 13.89 and a standard deviation of 4.92, indicating varied fiscal capacities among the regions. A Jarque–Bera probability value of 0.163 (> 0.05) indicates that the KK data follow a normal distribution. Local own-source revenue (PAD) and capital expenditure (BM) record mean values of 0.25 and 0.26, respectively, with relatively low variability (standard deviation <

0.15). Both variables also satisfy the normality assumption, with probability values of 0.065 and 0.177, respectively.

Table 3.
Descriptive Statistics of Model 2

	PER	PAD	BM	KK
Mean	57.01421	0.253699	0.260024	13.89196
Median	5.055200	0.280000	0.240000	14.17431
Maximum	618.1373	0.546000	0.678000	25.62500
Minimum	-3.535836	0.039000	0.051000	5.809642
Std. Dev.	156.0134	0.144655	0.132359	4.920766
Skewness	2.789455	-0.020253	0.491873	0.472396
Kurtosis	9.207120	1.744665	2.818739	2.605201
Jarque-Bera	240.8819	5.455546	3.460454	3.626055
Probability	0.000000	0.065365	0.177244	0.163159
Sum	4732.180	21.05700	21.58200	1153.032
Sum Sq. Dev.	1995895.	1.715851	1.436558	1985.543
Observations	83	83	83	83

Source: processed data

The analysis of Model 2 shows that regional economic growth (PER) exhibits a very wide range, with a maximum value of 618.14 and a minimum of −3.54. The mean PER value (57.01), substantially exceeding the median (5.06), together with a high kurtosis value (9.21), indicates a leptokurtic distribution with extreme values (outliers). As a result, the Jarque–Bera test produces a probability of 0.0000, indicating that the PER data do not follow a normal distribution statistically. Nevertheless, the study considers the use of the Random Effect Model (REM) with the Generalized Least Squares (GLS) approach to be consistent and robust to violations of the normality assumption. This robustness relies on the application of the Central Limit Theorem (CLT), given the sufficient number of observations (N = 83) to generate efficient estimates (Greene, 2002).

Selections of Panel Data Estimated Model

Model 1 Selection

The Chow test of model 1 determined whether the FEM model was better than CEM by examining the presences of individual specific effect among the regencies.

Table 4
Chow Test Results of Model 1

Redundant Fixed Effects Tests **Equation: Untitled** **Test cross-section fixed effects**			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	8.963213	(4,76)	0.0000
Cross-section Chi-square	32.075421	4	0.0000

Source: processed data

Based on Table 4, the cross-section chi-square probability value is 0.0000 (< 0.05). This result provides strong statistical evidence of individual-specific effects across districts, indicating that the Fixed Effect Model (FEM) outperforms and is therefore preferred to the Common Effect Model (CEM) for estimating Model 1. The next step applied the Hausman test to compare the effectiveness of FEM and the Random Effect Model (REM).

Table 5
Hausman Test of Model 1

Correlated Random Effects - Hausman Test **Equation: Untitled** **Test cross-section random effects**			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.143645	2	0.5645

Source: processed data

The Hausman test results in Table 5 report a cross-section random probability value of 0.5645 (> 0.05). This finding indicates that district-specific effects do not correlate with the independent variables (PAD and BM). Accordingly, the Random Effect Model (REM) is more efficient and becomes the preferred model over FEM for further analysis. The subsequent step applies the Lagrange Multiplier test to compare REM and CEM.

Table 6
Hausman Test of Model 1

Lagrange Multiplier Tests for Random Effects **Null hypotheses: No effects** **Alternative hypotheses: Two-sided (Breusch-Pagan) and one-sided (all others) alternatives**			
	Test Hypothesis		
	Cross-section	Time	Both
Breusch-Pagan	50.66651	5.283242	55.94976
	(0.0000)	(0.0215)	(0.0000)
Honda	7.118041	-2.298530	3.407909
	(0.0000)	(0.9892)	(0.0003)
King-Wu	7.118041	-2.298530	5.466563
	(0.0000)	(0.9892)	(0.0000)
Standardized Honda	8.807352	-2.063142	0.413185

	(0.0000)	(0.9805)	(0.3397)
Standardized King-Wu	8.807352	-2.063142	3.625407
	(0.0000)	(0.9805)	(0.0001)
Gourieroux, et al.	--	--	50.66651 (0.0000)

Source: processed data

Based on Table 6, the Breusch–Pagan probability value is 0.0000, below the 0.05 significance level. This result confirms the presence of random district-specific variation in the dataset. Therefore, the Random Effect Model (REM) is statistically superior and more appropriate than the Common Effect Model (CEM) for estimating regional financial performance variables.

Model 2 Selection

Table 7
Chow Test Results of Model 2

Redundant Fixed Effects Tests **Equation: Untitled** **Test cross-section fixed effects**			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	4.702381	(4,75)	0.0019
Cross-section Chi-square	18.573596	4	0.0010

Source: processed data

Based on Table 7, a probability value of 0.0019 falls below the 0.05 significance threshold. This result confirms significant heterogeneity, or fixed effects, across districts in the former Pati Residency. Accordingly, the Fixed Effect Model (FEM) outperforms the Common Effect Model (CEM) and is selected as the more appropriate specification for Model 2.

Table 8
Hausman Test of Model 2

Correlated Random Effects - Hausman Test **Equation: Untitled** **Test cross-section random effects**			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.354655	3	0.7162

Source: processed data

Based on Table 8, a probability value of 0.7162 exceeds the 0.05 significance level. This finding indicates no significant correlation between district-specific effects and the

independent variables in the model. Consequently, the Random Effect Model (REM) demonstrates superior efficiency and is chosen as the optimal estimation model over FEM for the analysis of Model 2.

Table 9
Lagrange Multiplier Test of Model 2

Lagrange Multiplier Tests for Random Effects **Null hypotheses: No effects** **Alternative hypotheses: Two-sided (Breusch-Pagan) and one-sided (all others) alternatives**			
	Test Hypothesis		
	Cross-section	Time	Both
Breusch-Pagan	13.27282	0.672508	13.94533
	(0.0003)	(0.4122)	(0.0002)
Honda	3.643188	-0.820066	1.996249
	(0.0001)	(0.7939)	(0.0230)
King-Wu	3.643188	-0.820066	2.949367
	(0.0001)	(0.7939)	(0.0016)
Standardized Honda	5.224351	-0.533579	-1.192633
	(0.0000)	(0.7032)	(0.8835)
Standardized King-Wu	5.224351	-0.533579	0.760751
	(0.0000)	(0.7032)	(0.2234)
Gourieroux, et al.	--	--	13.27282
			(0.0005)

Source: processed data

Table 9 show a probability value of 0.0003, which is less than the 0.05 level of significance. This result provides strong evidence of significant random variation across districts in the study area. Consequently, the Random Effect Model (REM) is statistically superior and more appropriate than the Common Effect Model (CEM) for explaining regional economic growth dynamics in Model 2.

Test Results of Model 1

Model 1 testing analyzed the effects of local own-source revenue (PAD) and capital expenditure (BM) on financial performance (KK). Before testing the hypotheses, the study first confirmed that the model satisfied the classical assumption criteria. The Jarque–Bera normality test yields a probability value of 0.000000. Although this value falls below 0.05,

the study still meets the normality assumption based on the Central Limit Theorem (CLT), because the number of observations (N = 83) exceeds 30, and because the Random Effect Model (REM) with Generalized Least Squares (GLS) estimation is robust to violations of normality (Greene, 2002). The multicollinearity test reports a correlation coefficient of 0.5178 between PAD and BM, which remains below the 0.85 threshold, indicating no multicollinearity problem. Furthermore, the use of GLS within the REM framework structurally corrects heteroskedasticity and autocorrelation by adjusting data variance and correcting error correlations, ensuring that the model estimates satisfy the properties of the Best Linear Unbiased Estimator (BLUE).

Table 10 provides the regression analysis results of model 1.

Table 10
Test Results of Model 1

Dependent Variable: KK
Method: Panel EGLS (Cross-section random effects)
Date: 11/22/25 Time: 12:00
Sample: 2006 2024
Periods included: 19
Cross-sections included: 5
Total panel (unbalanced) observations: 83
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.417558	1.039056	6.176334	0.0000
PAD	31.13654	2.286633	13.61676	0.0000
BM	-1.969318	2.420035	-0.813756	0.4182
R-squared	0.763810	Mean dependent var		4.031745
Adjusted R-squared	0.757905	S.D. dependent var		4.653172
S.E. of regression	2.272882	Sum squared resid		413.2794
F-statistic	129.3553	Durbin-Watson stat		1.328199
Prob(F-statistic)	0.000000			

Source: processed data

Based on Table 10, the adjusted R-squared value of 0.758 indicates that PAD and capital expenditure explain 75.8% of the variation in financial performance, while variables outside the model account for the remaining 24.2%. The F-test produces a probability value of 0.0000 (< 0.05), indicating that PAD and capital expenditure jointly have a significant effect on financial performance; therefore, the model is statistically valid. Partial testing (t-test) shows that local own-source revenue (PAD) has a positive and significant effect on financial performance (KK), as indicated by a t-statistic of 13.6168 and a probability value of 0.0000. Accordingly, Hypothesis 1 (H1) is accepted, confirming that increases in PAD in the former Pati Residency significantly improve regional financial performance. In contrast, capital expenditure (BM) records a t-statistic of −0.8138 with a probability value of 0.4182 (> 0.05), indicating no significant effect on financial performance; therefore, Hypothesis 2

(H2) is rejected. The insignificant effect of capital expenditure reflects its nature as a long-term investment that does not generate immediate returns within the current period. This condition indicates inefficiencies in budget allocation and a suboptimal fiscal multiplier effect, wherein expenditures on infrastructure and fixed assets diminish regional cash liquidity without fostering short-term growth in local own-source revenue (PAD).

Test Results of Model 2

Model 2 testing aims to examine the joint effects of local own-source revenue (PAD), capital expenditure (BM), and financial performance (KK) on regional economic growth (PER). Before hypothesis testing, the study conducts classical assumption tests to ensure model validity. The Jarque–Bera normality test produces a probability value of 0.0000. Although this value is below 0.05, the assumption can be relaxed because the large number of observations (N = 83 > 30) satisfies the Central Limit Theorem (CLT). In addition, the Random Effect Model (REM) with Generalized Least Squares (GLS) estimation effectively handles non-normally distributed data (Greene, 2002).

The multicollinearity test identifies the highest correlation coefficient between PAD and KK at 0.8377. Because this value remains below the critical threshold of 0.85, the model shows no serious multicollinearity among the independent variables. Moreover, the GLS method automatically corrects heteroskedasticity and autocorrelation by adjusting data variance and error relationships, ensuring that the estimated parameters remain accurate and unbiased.

Table 11 provides the regression analysis results of model 2.

Tabel 11
Test Result of Model 2

Dependent Variable: PER
Method: Panel EGLS (Cross-section random effects)
Date: 11/22/25 Time: 12:17
Sample: 2006 2024
Periods included: 19
Cross-sections included: 5
Total panel (unbalanced) observations: 83
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	23.24747	73.99822	0.314162	0.7542
PAD	101.2410	261.6024	0.387003	0.6998
BM	-51.79200	152.8357	-0.338874	0.7356
KK	1.238937	7.043453	0.175899	0.8608
R-squared	0.013183	Mean dependent var		19.04575
Adjusted R-squared	-0.024291	S.D. dependent var		141.0325
S.E. of regression	142.8137	Sum squared resid		1611264.
F-statistic	0.351781	Durbin-Watson stat		2.887694
Prob(F-statistic)	0.787959			

Source: processed data

Based on Table 11, the adjusted R-squared value of −0.032 indicates that local own-source revenue (PAD), capital expenditure, and financial performance have very limited explanatory power for variations in regional economic growth. The F-test produces a probability value of 0.9385 (> 0.05), indicating that, simultaneously, these three variables do not significantly affect regional economic growth in the former Pati Residency.

Partial testing (t-test) shows that PAD records a probability value of 0.6998 (> 0.05); therefore, Hypothesis 3 (H3) is rejected. Capital expenditure (BM) records a probability value of 0.7356 (> 0.05); therefore, Hypothesis 4 (H4) is rejected. Financial performance (KK) records a probability value of 0.8608 (> 0.05); therefore, Hypothesis 5 (H5) is rejected. These findings indicate that fiscal factors and the administrative performance of local governments in the study area did not effectively stimulate real-sector growth during the observation period.

Sobel Test

Table 12
Sobel Test Results

Influence	Coefficient	Standard Error	Prob.	Sobel Test Statistic
PAD→ KK	31.14	2.289	0.0000	0.18
BM → KK	-1.96	2.42	0.4182	-0.17
KK → PER	1.24	7.04	0.8608	-

Effects of Local Own-Source Revenue on Financial Performance

Based on the test results, local own-source revenue (PAD) shows a positive and significant effect on regional financial performance. This finding indicates that the more effectively a region optimizes its local revenue potential—such as local taxes and levies—the stronger its financial performance foundation becomes. The empirical evidence of the current research supports hypothesis 1 (H1).

The resource dependence theory, which holds that areas with robust internal resources perform better financially because they depend less on transfers from the federal government, is consistent with this finding. Local governments have more freedom to allocate funds in accordance with local priorities when there is less reliance. According to the stakeholder theory, the government's duty to autonomously manage local economic potential is reflected in the successful PAD enhancement (Musyarofah & Indarti, 2014). These results corroborate earlier research by Musyarofah & Indarti (2014), which found that PAD optimization is a significant factor in determining the financial health of a region.

Effects of Capital Expenditure on Financial Performance

Hypothesis testing further reveals that capital expenditure does not affect financial performance in the former Pati Residency. This finding indicates that the size of budget allocations for fixed assets does not directly determine fiscal independence during the observation period. Consequently, Hypothesis 2 (H2) is dismissed.

Theoretically, the lack of effect of capital expenditure on financial performance (the independence ratio) reflects the long-term investment nature of capital spending. Infrastructure development or fixed-asset procurement in the current year reduces regional cash balances, while the economic benefits—such as increased PAD—do not materialize

immediately. The former Pati Residency shows evidence of a time lag; whereby current physical development affects economic productivity and regional revenue only in subsequent periods. This finding aligns with (Fauzan & et. al., 2022), who argue that capital expenditure requires consistent allocation and sufficient time to generate measurable improvements in financial performance.

Effects of Local Own-Source Revenue, Capital Expenditure, and Financial Performance on Regional Economic Growth

Analysis of Model 2 yields an adjusted R-squared of −0.032, indicating that the independent variables explain very little variation in regional economic growth. Simultaneously, the F-test probability of 0.9385 (> 0.05) confirms that the model lacks significance. Partially, PAD, capital expenditure (BM), and financial performance (KK) do not significantly affect regional economic growth (PER). Accordingly, Hypotheses 3 (H3), 4 (H4), and 5 (H5) are statistically rejected.

These results indicate a disconnect between regional fiscal indicators and real economic growth outcomes in the former Pati Residency during the study period. Several fundamental macroeconomic and governance factors explain this weak relationship.

First, external factors and strong private-sector dominance play a major role. Economic growth in the former Pati Residency—particularly in regions with large industrial bases such as Kudus (cigarette industry) and Jepara (furniture industry)—likely responds more to global market fluctuations, private investment activity, and household consumption than to direct fiscal stimulus from regional budgets. This pattern aligns with stakeholder theory, which views government as only one actor among many, while key economic stakeholders—especially businesses—respond more dynamically to the national macroeconomic climate.

Second, regional spending structures remain suboptimal. Local governments tend to absorb budgets through routine and personnel expenditures, which generate relatively small multiplier effects on productive sectors compared with well-targeted capital spending. Third, the financial performance indicator used in this study primarily captures the administrative dimension and the "bookkeeping" health of local governments, particularly the fiscal independence ratio. In theory, a region may display strong administrative financial performance while economic growth still slows due to factors beyond local fiscal control.

These findings support (Rachman & et. al., 2023), who report that government financial performance indicators do not always correlate linearly with macroeconomic growth. To stimulate economic growth, local governments therefore need to move beyond fiscal independence and administrative accountability and design policies that attract private investment and strengthen leading sectors in the former Pati Residency.

Mediating Role of Financial Performance

Path analysis and the Sobel test show that financial performance (KK) does not mediate the relationship between local own-source revenue (PAD) or capital expenditure (BM) and regional economic growth (PER). The Sobel test yields t-statistics of 0.18 for the PAD path and 0.06 for the BM path, both far below the critical t-value of 1.99. These results confirm that indirect effects through financial performance lack statistical significance and do not strengthen the influence of fiscal variables on economic growth in the former Pati Residency. Accordingly, Hypotheses 6 (H6) and 7 (H7) are rejected.

Several analytical considerations explain the insignificant mediating role. First, a clear gap exists between fiscal achievements and real-sector economic outcomes. Descriptive statistics show that although regions in the former Pati Residency have improved fiscal capacity through higher own-source revenue and increased capital expenditure, these gains have not translated into tangible stimuli for community economic growth. This pattern indicates that various technical and structural constraints still obstruct the transmission of fiscal health through economic productivity.

Second, the financial performance, as indicated by the fiscal independence ratio, remains primarily administrative and concentrates on the health of internal budgets. In contrast, regional economic growth requires more direct and substantive interventions in leading sectors, such as supporting MSMEs, strengthening the furniture industry supply chain in Jepara, enhancing processing industries in Kudus, and creating a conducive investment climate beyond budgetary adjustments alone. From a stakeholder theory perspective, local governments have not yet aligned financial performance with the expectations of all economic stakeholders in driving real-sector activity.

These findings align with the logic of (Rachman & et. al., 2023), which emphasizes that indicators of government financial health do not automatically guarantee accelerated regional macroeconomic growth. The results reinforce the view that the relationship between public financial management and economic outcomes is complex and non-linear through administrative financial performance. Therefore, fiscal policy should focus not only on budgetary independence but also on allocation effectiveness that directly improves community economic welfare.

CONCLUSION

This study examined the direct and indirect effects of local own-source revenue (PAD) and capital expenditure on regional economic growth, with financial performance serving as a mediating variable. The results of Model 1 show that PAD positively and significantly affects financial performance, confirming that stronger capacity to mobilize local revenue reinforces regional fiscal independence. In contrast, capital expenditure management does not affect financial performance. The results of Model 2 indicate that PAD, capital expenditure, and financial performance do not significantly influence regional economic growth. In the mediation framework, financial performance does not facilitate the connection between these fiscal variables and economic growth in the former Pati Residency.

These findings have theoretical and practical implications. The results theoretically demonstrate that PAD is a crucial resource for local governments to reduce reliance on outside parties, which is consistent with the predictions of resource dependence theory. The fact that administrative financial indicators by themselves cannot ensure stakeholder satisfaction, as demonstrated by economic growth, underscores the challenges of putting stakeholder theory into practice in the public sector. Local governments can practically use these findings to inform the development of fiscal policies. Financial performance management should extend beyond achieving administrative fiscal independence ratios and should aim to generate tangible multiplier effects for the real sector and public welfare.

Despite the contribution, the current research has limitations, such as low adjusted R-square score of Model 2. This matter indicates the regional economic growth is excellent and

mostly explained by various unobserved variables. Another important matter deals with – only local own-source revenue significantly influences the regional financial performance. Thus, predicting more accurate regional economic growth requires future studies to consider macro-economic factors or more specific government management, such as human resource quality, private investment level, and regional auditory board structure, to optimize the fiscal policy for the community.

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