International Journal of Public Policy and Administration Research
2022 Vol. 9, No. 2, pp. 33-45.
ISSN(e): 2312-6515
ISSN(p): 2313-0423
DOI: 10.18488/74.v9i2.3024

AN ANALYSIS OF REGIONAL ECONOMIC PERFORMANCE OF RIAU ON THE CAPITAL EXPENDITURE BUDGET: A STUDY OF INDONESIAN TERRITORIAL ECONOMICS

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Article History
Received: 31 January 2022
Revised: 12 May 2022
Accepted: 27 May 2022
Published: 10 June 2022

Keywords
Capital expenditure budget
Economic growth
Financial governance and budgeting
Gross regional domestic product
Regional economy
Regional economic performance of Riau.

ABSTRACT

This study aims to assess the economic performance of Riau Province, Indonesia, both within the region and on a national scale. The research methodology used in this study is a descriptive statistical approach. The results of quantitative data processing are interpreted in an effort to develop the macroeconomic theories and frameworks relating to financial governance and regional budgets. The results of the study conclude that the economic performance of Riau has experienced a downward trend in recent years. In 2017, it reached IDR 471.42 trillion and grew about 2.71%, measured using Gross Regional Domestic Product (*GRDP*) at constant 2010 prices. In 2017, the Regional Expenditure Budget experienced a decline compared to 2016, in which it was IDR 35.44 trillion. Based on data analysis and interpretation, we propose frameworks for regional economic performance and the regional financial capability theory.

Contribution/Originality: The results of this study contribute to the expansion of the regional and national economic development theory of a country. Practically, it has implications for public management and regional financial governance, as well as providing a framework for the work of the central government based on the regional autonomy approach.

1. INTRODUCTION

Riau Province, Indonesia, is an area rich in natural resources. Since the Indonesian Independence (1945), it has been argued that the approach to economic development in the area has brought insufficient prosperity to the people (Trihatmoko & Susilo, 2018). The national political policy in the reform era (2000), in the form of regional autonomy and the designation of special areas, has not significantly reduced the national problem of poverty in Indonesia. Trihatmoko (2019) highlighted that, in many Indonesian regions, poverty levels are above 10% (see, Harian National (2019)). This study explores the economic performance of Riau in terms of financial governance and the Regional Revenue and Expenditure Budget *(RREB)*. It is expected that the review and analysis presented in this study will become a template that can be applied to other regions in Indonesia.

The implementation of regional financial reforms, in line with the implementation of regional autonomy, indicates that certain regions are unable to finance their regional budgets due to their low fiscal capacity. Each presentation of government financial reports describes the structure of expenditure applied by each regional government, thus the strengthening aspects of financial expenditure are expected to boost the regional economy.

Sjafrizal (2014) stated that the demand to change the expenditure structure of the regional governments was getting stronger, particularly in regions with a low fiscal capacity. Strengthening the structure of regional expenditure is a regional financial strategy that can increase public confidence. This is necessary since the budget used by the government to carry out regional development activities is public. The expenditure allocation made every year by the regional government must truly be utilized for productive economic activities.

Preliminary observative analysis identifies a classic phenomenon in Riau's government, in which the regional expenditure budget has increased every year; however, this is not matched by an increase in the capital expenditure budget. This can be seen when comparing the revenue and expenditure budgets of each region in Indonesia. The ratio between capital expenditure and the total Regional Revenue and Expenditure Budget *(RREB)* of Riau is only 16%. This is comparable to the ratios of local governments (regencies/cities) throughout Indonesia, which have an average capital expenditure of only 21% of the total Regional Revenue and Expenditure Budget *(RREB)*.

The increase in government spending from year to year has implications for the real sector macroeconomy, which affects consumption and investment, and which in turn impacts the national economic growth and the welfare of the people. This should ideally be followed by a responsive absorption pattern of funds relating to the role of the Regional Revenue and Expenditure Budget *(RREB)* as a stimulus for economic growth. The tendency for budget absorption to escalate at the end of the year indicates that budget execution is not optimal. The first question that must be answered is: How does the historical performance of the Riau economy relate to that of other regions in Indonesia?

From the perspective of public management, regional fiscal policy through Regional Revenue and Expenditure Budget *(RREB)* governance is an effort to encourage the autonomy of the region. This matter is in accordance with the spirit of government policy in implementing regional autonomy that is effective, efficient, and productive. Moreover, the underlying motivation of the regional fiscal capacity, particularly in the capital expenditure of the provincial Regional Revenue and Expenditure Budget *(RREB)*, is intended to increase regional competitiveness. This argument leads to the formulation of the second question: How do the indicators of Economic Growth or Gross Regional Domestic Product *(GRDP)*, Regional Original Revenue *(ROR)*, General Allocation Fund *(GAF)*, and Special Allocation Fund *(SAF)* affect the Budget Capital Expenditure *(BCE)* of district/city governments in Riau?

The purpose of this study is to assess the economic performance of Riau, both within its territory and at the national level, and to analyze the effect of each economic performance indicator on the Capital Expenditure Budget. The theoretical contribution of the study's results is to increase the understanding of regional economic development in Indonesia, as well as to extend macroeconomic theory in terms of theories and concepts viewed in the context of the constitutional economy or the Indonesian political economy. Practically, it has implications for public management and regional financial governance, both for the Regional Government of Riau and the Regency/City, as well as other regions in Indonesia. The general objective is to serve as a reference for the work of the central government in order to optimize the national development programs for the separate regions based on the regional autonomy approach.

2. LITERATURE REVIEW

2.1. Constitutional Economics

The term 'Constitutional Economics' (Constitutional Political Economy) was introduced to define and classify a distinct strand of research inquiry and related policy discourse in the 1970s and beyond. The subject matter was not new or novel, however, and it may be argued that constitutional economics is more closely related to the work of Adam Smith and the classical economists than its modern 'non-constitutional' counterpart. Both areas of inquiry involve positive analysis that ultimately aims to contribute to the discussion of policy questions. The difference lies in the level or setting of the analysis, which, in turn, implies communication with different audiences. The basic review of constitutional economics in this study is based on Law no. 23/2014 on the Regional Government *(UU-23/2014)*. The government administration is based on the principle of decentralization, the burden of the Regional Revenue and Expenditure Budget *(RREB)*. The financing referred to is within the framework of the co-administration being financed, thus becoming a burden on the budget at the assigning government level. *UU-23/2014* states that the implementation of regional governance aims to accelerate the realization of community welfare through improved services, empowerment, and community participation. The goal is to increase regional competitiveness through the principles of democracy, equity, and justice, as well as the uniqueness of each region in the system of the Unitary State of the Republic of Indonesia. The meaning of the economic constitution is described in the following studies, which serve as a guide for the research theorization.

The role of local government in the implementation of regional autonomy is to create harmony and balance (Mardiasmo, 2002; Priyarsono, 2011; Sjafrizal, 2014). Harmony by providing services, increasing participation and initiative, and empowering people who pay attention to the interests and aspirations of society. Balance by managing relations between levels of government, between regions, and between the center and regions. The main instrument in the implementation of fiscal decentralization is funding the transfer of functions to regions in a way that is proportional, fair, democratic, and transparent by considering the region's potential and needs. The financial balance between the center and the regions is based on the distribution of financial resources (financial sharing), which aims to empower each region, increase their autonomy, and reduce gaps between regions in their ability to finance their autonomy, as well as to create a payment system that is fair, proportional, rational, and secure in the financial sources originating from the region concerned (Priyarsono, 2011). Fiscal decentralization means financial governance must be implemented effectively, efficiently, and accountably to support public services. It involves shifting some responsibilities for expenditures and/or revenues to lower levels of government. One important factor in determining the type of fiscal decentralization is the extent to which subnational entities are given autonomy to determine the allocation of their expenditures.

The Regional Original Revenue *(ROR)* consists of the revenues from local taxes, regional levies, income from regional company profits, and other income that is considered legitimate (Erlina, Sirojuzilam, & Rasdianto, 2012; Mahmudi, 2010; Mardiasmo, 2002). The sources of regional revenue in the form of Regional Original Revenue *(ROR)* and transfers (General Allocation Funds, Revenue Sharing Funds, Special Allocation Funds, and Autonomy Funds) are expected to increase economic growth and improve the welfare of people in the area. Economic growth is defined as an increase in revenue to the amount of the value of goods and services produced by an economy within one year. Increasing the Regional Original Revenue *(ROR)* is a conventional approach that local governments can take to increase the capacity of their regions. The difference in economic potential between regions is quite large, which allows certain regions to strive to increase their Regional Original Revenue *(ROR)* through efforts to explore the existing regional potential that has not been maximally utilized (Sjafrizal, 2018). It is expected that an increase in Regional Original Revenue *(ROR)* will increase the local government's capital expenditure investment, improving the quality of public services. However, the critical problem that occurs is that an increase in local revenue is not followed by a significant increase in the capital expenditure budget.

The relevance of the Regional Original Revenue *(ROR)* and the Regional Revenue and Expenditure Budget *(RREB)* is constitutionally regulated by the central government in the form of Government Regulation No. 58 of 2005 *(PP-58/2005)*. The policy states that every time the Regional Revenue and Expenditure Budget is prepared, the allocation of capital expenditures must be adjusted to the needs of the region by taking into account the Regional Original Revenue received (Erlina et al., 2012; Mahmudi, 2010). Regional governments that expect to increase capital expenditure for public services and public welfare are directed to explore the sources of their Regional Original Revenue *(ROR)* as much as possible. However, it is doubtful whether the expected improvements to public services and welfare can be realized.

The reality of the inter-central-regional fiscal relationship is marked by the a high degree of central control over the regional development process (Suwarno, in Yustika (2008)). This can be clearly seen from the low proportion of original regional revenue to total regional revenue, which is not proportional to the number of subsidies (grants) provided by the center. Almost all districts and cities in Indonesia face the problem of the limited ability of local governments to finance development activities in their area. This is due to the lack of funds and sources of funds in the regions that are able to finance the implementation of governance and development in the regions.

2.2. Theoretical

Previous research on the governance of the Regional Revenue and Expenditure Budget *(RREB)* and the regional economy is still somewhat difficult to trace; therefore, this paper begins by describing it to provide a fresh perspective. The Regional Revenue and Expenditure Budget *(RREB)* consists of three main components, namely revenue, routine expenditure, and development expenditure (Nurul Badriyah, in Yustika (2008)). One way of evaluating the performance of regional economic development is to analyze the performance of the Regional Revenue and Expenditure Budget *(RREB)*, which has been determined and implemented for use as a parameter in assessing/measuring (Isyandi, 2017; Mardiasmo, 2002; Sjafrizal, 2014): (1) the regional financial independence in financing the implementation of the regional autonomy; (2) the effectiveness and efficiency in realizing the regional revenue; (3) the regional government's activities in spending their regional income; (4) the contribution of each source of income to the entire regional income; and (5) the growth/development of revenue and expenditure generated during a certain period.

To achieve economic growth, fixed assets are needed that can support economic activity (Jhingan, 2014). The construction of these fixed assets is funded by the allocation of the capital expenditure budget. If the economic growth of a region increases, the regional government will increase its capital spending to repair and equip infrastructure to achieve better economic growth (Sjafrizal, 2018). This is in line with Sirojuzilam and Bahri (2014), who argued that economic growth encourages or demands an increase in services from the government to smooth economic activity. Economic growth is also driven by productivity gains, measured by how much each hour of worker time produces in output. A free-market economy encourages technological innovation.

Classical economics refers to the school of economic thought adopted by Western democracies in the 18th and 19th centuries. This school of thought was brought into the mainstream by Scottish economist Adam Smith, who many refer to as the "father of economics." Classical economics rejects the idea of the government intervening in the marketplace. The theory is that any problem will eventually be resolved by the markets. Classical economists are largely in favor of free trade. Classical economic thinking states that economic development in regions rich in natural resources will be more advanced and the people more prosperous than in regions that are poor in natural resources (Sukirno, 2006; Sukirno, 2005). Differences in development level based on regions' different levels of potential have an impact on the occurrence of sectoral differences in the formation of the Gross Regional Domestic Product *(GRDP)*. The growing role of the economic sector's potential in adding value to the growth of the Gross Regional Domestic Product *(GRDP)* should be able to encourage regional development so that, in turn, the allocation of regional capital expenditures can be increased. High economic growth encourages local governments to carry out regional development, which is realized in the form of facilities and infrastructure aimed at the public interest (Sjafrizal (2014). Regional needs for facilities and infrastructure, both to ensure the continuity of the implementation of government tasks and to create public facilities, affect the amount of capital expenditure. Thus, local governments should adjust the composition of their spending, which in turn can increase public confidence.

Infrastructure development (roads, bridges, ports, and airports) has a real impact on the development of the manufacturing industry, which has a considerable impact on local tax increases (Sirojuzilam & Bahri, 2014). The creation of public facilities stimulates the community to feel comfortable and to run their businesses efficiently and effectively, which will increase public participation in the development. Higher levels of capital investment are expected to be able to improve the quality of public services and thus increase the level of public participation in the development, as reflected by an increase in the Regional Original Revenue *(ROR)* (Suwarno, in (Mardiasmo, 2002; Yustika, 2008). The increasing acceptance of Regional Original Revenue *(ROR)* will certainly allow for an increase in the allocation of regional government capital expenditures, which will ensure the increasing quantity and quality of public services. The high Regional Original Revenue *(ROR)* will then be reinvested by the regional government to build more quality public service facilities, meaning that there will be an increase in the capital expenditures of the local government in accordance with the ideals of regional autonomy.

In line with the development needs of the region, one of the important efforts a region must make is to understand perceptions and increase its operational capacity (Isyandi, 2009; Jhingan, 2014; Priyarsono, 2011; Sjafrizal, 2018). Development activities require funding (investment in capital equipment) to finance every detail of the programs and activities that are planned or implemented so that national and regional development plans can be aligned with each other. Politically, the implementation of autonomy has brought about a significant increase in the authority of provinces and cities/districts to plan and implement various government policies. However, from an economic point of view, this does not indicate the extent of the regional authority in planning and allocating the regional sources of finance. This means that the regional government still has a significant degree of financial (fiscal) dependence on the central government.

On the other hand, each city/district government faces various fundamental problems that require financing. One of the problems is the financing required to increase the scope of programs due to the rapidly increasing population (Sjafrizal, 2018; Tarigan, 2007). This is illustrated by the demands on local government financing for spending on pensions, social security, health, and other facilities. In addition, over the next five years, the need for local governments to spend on school-age residents is still quite large. Thus, the city/district government is faced with the problem of an increasing need for financing amid conditions of great fiscal dependence. This requires a fiscal transfer policy from the central government to the regions capable of solving this problem (Jhingan, 2014; Sjafrizal, 2018; Yustika, 2008).

The theoretical review above is in line with Law no. 33 of 2004 concerning the financial balance between the Central Government and Local Government *(UU-33/2004)*. The World Bank and UNDP provide a reference for the necessary orientation of public sector development to achieve good governance. The World Bank defines good governance as the implementation of solid and responsible development management, in line with the principles of democracy and efficient markets, avoiding misallocation of investment funds and preventing both political and administrative corruption, implementing budget discipline, and creating a legal and political framework for the growth of business activities (Mardiasmo, 2002).

3. METHODS

This study on the Indonesian territorial economy was conducted in Riau, Sumatra. Most of the subjects of the study were from Pekanbaru, the center of Riau Province, since this is where the regional fiscal and financial control are located. The Province of Riau was selected among the regions of Indonesia, because (1) it is a prime example of the low absorption capacity of the Regional Revenue and Expenditure Budget *(RREB)*; (2) since 2012-2014 it has had *SILPA* at IDR 1.9 trillion and IDR 1.4 trillion and IDR 3.9 trillion; (3) all this time, its economic growth has been above the national average, despite the lowest levels currently being on the island of Sumatra; (4) it is known as a region that always receives a large amount of revenue sharing from its natural resources; however, its level of development in the quality of human resources and manpower is still considered to be lagging.

The data in this study was collected using surveys along with developmental research methods or observative quantitative data. The data were grouped into two major types: secondary and primary data. The primary data were collected using the Rapid Rural Appraisal (RRA) method, which is a participatory approach to obtain data/information and perform a general assessment (evaluation) in the field of study in a relatively short time. The advantage of this approach is that the research can cover a larger area in a relatively short time to obtain a broad coverage in general. The information and data collection was carried out flexibly, not rigidly tied to a questionnaire. This methodological procedure was adopted to simultaneously trace the regional economic performance of Indonesia, where the analysis has relevance to Riau in the years from 2010 to 2015.

Quantitative descriptive statistical analysis is used to describe or provide an overview of the object of the research through sample or population data and to draw general conclusions. The results of the statistical analysis are used to provide an overview of the interrelated variables. Statistical data processing is used to provide descriptions of free and bound variables through the use of frequency tables, focusing on the economic performance of Riau in 2017.

The methodology for collecting and analyzing the data mentioned above was applied by simultaneously integrating relevant secondary data into the primary data, including reference tracing from various related agencies. The form of analysis was integrated into a series of information systems consisting of subsystems, each of which was an input analysis that led to one activity unit to obtain conclusions about the fiscal capacity to increase regional competitiveness. The quantitative data analysis was interpreted to construct new theories about the constructs of the regional economy related to the local government's financial governance.

4. RESULT AND DISCUSSION

4.1. Historical Analysis and Descriptions of Economic Performance

The first description of the findings of this study is as a general analytical tool. The results of the study identified the historical performance of the economy in Riau based on an analysis of the data from the Riau Province Central Bureau of Statistics, from 2011 to 2015. In the context of this study, these results are also intended to show a comparison between Riau's regional economic performance and several other cities/regencies, as well as with other Sumatra Island areas and other regions in Indonesia.

The acceleration of economic growth in Riau has tended to weaken. During the study period, the world oil price fluctuated, and oil and gas production experienced many problems, both technical and non-technical, due to the condition of several oil wells, which were starting to age. The conditions that affect oil and gas production also affect the general economic movement of Riau. The contribution of oil and gas, when it is very dominant in the economy of a district/city, has the effect of causing direct instability to the economic growth in the region.

The analysis of oil and gas instability in 2014, which was only 2.62%, generally affected the economic growth of districts/cities with large oil and gas resources. Bengkalis Regency's growth rate was -3.50%, Siak Regency's was -0.71%, Kampar Regency grew by 3.21%, and Rokan Hilir Regency grew by 4.01%.

The economic conditions in Riau in 2015 were unfavorable, with a growth of only 0.22%. In that year, the economic growth of the Sumatra Island region reached 3.54%. The highest growth was found in the Riau Islands Province at 6.02%, and the lowest growth was in Aceh Province at -0.72%. In terms of economic performance, in 2015 Riau Province was in 9th position out of the 10 provinces on the island of Sumatra**.**

At the national level, the economic growth rate in 2015 was 4.79%, and the island of Sumatra contributed 22.21% to the economic structure in Indonesia. In this, Sumatra came second, after the island of Java, which had a share of 58.29% and an economic growth of 5.45%. This finding shows the rate of economic growth at the regional and national levels, where the economic growth in Riau Province was far below the regional and national averages.

Meanwhile, the Riau region has abundant natural resources in the petroleum and palm oil sectors (Isyandi & Trihatmoko, 2021; Trihatmoko & Susilo, 2018). Its struggles are thus in contrast to the expectations of classical economic theory and its emphasis on natural resource-based economic development leading to economic progress and the welfare of the people, as explained by Sukirno (2006) and Sukirno (2005). In this context, Riau Province's regional financial problems require the review of the existence of a central government to regional fiscal transfer policy (Jhingan, 2014; Sjafrizal, 2018; Yustika, 2008).

The following discussion and descriptive analysis of the historical findings of economic performance describe the theoretical structure as a premise (Pa.-...) and a minor proposition (P1.-...) for regional and national economic growth relating to regional finances. (Pa) Regional economic growth depends on fluctuations in the market for commodities produced by the natural resources in the region; (Pb) The provinces of Riau rely heavily on the production of natural resources – oil and gas – to increase regional revenue; (Pc) Oil and gas products from Riau are dependent on the national and international market situation; (Pd) On the other hand, the production of these natural resources requires the expenditure of capital from previous production income; (Pe) The aging of several oil wells illustrates that the condition of natural resources is a factor in decreasing or increasing their production; (Pf) The economic growth of the Riau region is part of the economic growth of Sumatra and Indonesia. Thus, the theory and the conceptual framework for the regional economic development in Indonesia are constructed as in Figure 1.

P1: Natural resource potential boosts the production capacity of external products of the regional economy.

P2: Fluctuations in prices and commodity markets have an impact on regional financial capacity.

P3: The production capacity of commodities has an impact on price fluctuations and the commodity product market.

P4: Regional financial capacity determines the production capacity of the product commodities in the region.

P5: Regional financial capacity determines regional economic growth.

P6: The production capacity of the commodity determines the economic growth of the region.

P7: The economic growth of each region contributes to the national economic growth.

This framework, illustrated in Figure 1, contributes to the understanding of macroeconomic science for countries, such as Indonesia, that have natural resource potential. At first glance, it may seem like common sense; however, this framework has not been described in the prior literature. The heart of regional economic growth lies in the region's financial capability related to development, in this case, the development of the production capacity of commodities from natural resources.

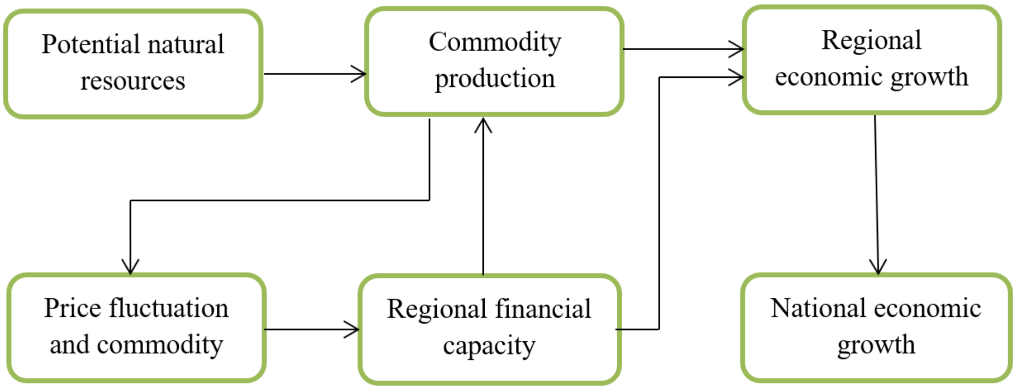

Figure 1. Regional economic performance based on natural resources.

The practical implications of this framework for a regional economy are dependent on the conditions and challenges of the national economy and the province of Riau itself. Almost all districts/municipalities in Indonesia face the problem of the limited ability of local governments to finance development activities in their regions. This is due to a lack of funds and financial resources in the regions. This has implications for the local governments, who demand allocation and fair distribution of authority and the power to determine public policies, as well as sources of financing, between the central and regional governments (General Allocation Fund *(GAF))* and Special Allocation Fund *(SAF)*). In addition, local governments are also encouraged to continue to explore and improve internal financial sources, namely Regional Original Revenue *(ROR)*. A study of the situation in the regencies/cities of Riau province shows that the percentage of Regional Original Revenue *(ROR)* to the Regional Revenue and Expenditure

Budget *(RREB)* was very low; the average percentage of Regional Original Revenue *(ROR)* was only 7.64% of the total Regional Revenue and Expenditure Budget *(RREB)*. Nonetheless, it is hoped that development can be carried out independently by the regions, in terms of planning, development, and financing. Regions are given greater authority to manage their own budgets. The purpose of this authority is to bring government services closer to the community, making it easier for the public to monitor and control the use of funds originating from the Regional Revenue and Expenditure Budget *(RREB)*.

The situation was intended to create healthy competition between regions and encourage innovation. One of the keys to the success of the government administration in the era of regional autonomy is to create and develop regional competitiveness. The competitiveness of a region can be increased by strengthening the regional economy through regional financial governance. In addition, in Indonesia regional competitiveness has been mapped for all counties and cities, showing the competitiveness ranking of each region.

4.2. Financial Performance Analysis and Capital Expenditure, 2016-2017

The regional autonomy policy gives greater authority to regencies and cities to take responsibility both for regional revenue and regional expenditure. Ideally, all local government expenditures can be fulfilled using their Regional Original Revenue, so that the region becomes fully autonomous and local dependence on the central government decreases. In this case, the regional financial capacity is explored using the aggregate profile of the Riau Province Regional Revenue and Expenditure Budget in 2017 presented in Table 1, which has been compiled to describe the region's performance. The results show that the total aggregate value of the 2017 Regional Revenue and Expenditure Budget in Riau Province was quite large, with an estimated income of IDR 32.38 trillion, an increase of IDR 2.42 trillion or 5.27% compared to 2016. However, the spending ceiling of IDR 33.84 trillion has decreased by IDR 1.60 trillion, or 4.70% compared to 2016. The regional government in Riau Province has a budget deficit, this is possibly not the case for most other regional governments in Indonesia.

Next, Table 1 shows that in aggregate, the Riau Province Regional Expenditure Budget is IDR 33.85 trillion. The 2017 Regional Expenditure Budget decreased compared to the 2016 Regional Expenditure Budget, which was IDR 35.44 trillion. Among the causes of the decrease in the Regional Expenditure Budget was a decrease in the Capital Expenditure Allocation in 2017 compared to 2016, which accounted for IDR 1.1 trillion.

The net financing aggregate in 2017 amounted to IDR 1.80 trillion. Total financing receipts amounted to IDR 1,830 trillion, most of which came from the use of SILPA in the previous year, which reached IDR. 1,826 trillion; the rest came from receivables and other non-permanent investment receipts.

Table 1. Riau province's regional revenue and expenditure budget profile, based on economic classification (in billion rupiah).

Description	2016	2017
Regional Revenue	30,763.21	32,384.31
Regional Original Revenue	6,119.15	7,390.51
Transfer Revenue	21,894.04	24,731.39
Other Legal Revenue	2,750.02	227.11
Regional Expenditure	35,437.75	33,845.78
Operational Expenditure	21,912.62	22,040.43
Capital Expenditure	8,482.35	7,380.36
Unexpected Expenditure	78.32	41.00
Transfer/Revenue sharing to regions	4,964.47	4,383.99
Surplus/Deficit	(4,674.55)	(1,461.46)
Regional Financing	4,899.87	1,874.23
Financing Receipt	5,027.22	1,909.57
Financing Expenses	127.35	35.34
SILPA *	225.33	412.76

Note: * *SILPA* is the Remaining Budget Financing for the Current Year, which is the difference between the budget surplus/deficit and net financing.
Source: Regional Government Financial Reports throughout Riau Province (2018).

This means that in Riau Province, no regional loans or regional bonds were contracted in 2017, as described in Table 2. The findings confirm that the use of financing expenditures for all regional governments in Riau Province does not include loans, since there are no expenditures for repayment of loans or regional bonds. The financing expenditure only takes the form of capital participation/investment in Regional Owned Enterprises (ROEs). This means that no interest is paid on loans; thus, the primary balance (the difference between the total regional income for regional expenditure other than interest expenditure) equals the budget surplus/deficit.

Table 2. The development of regional deficits and financing in Riau Province 2016-2017 (in billion rupiah).

Description	2017	2016
Regional Revenue	27,218.34	26,703.22
Regional Expenditure	28,958.48	29,730.66
Surplus (Deficit)	(1,740.14)	(3,027.45)
Financing	1,796.76	4,931.64
Financing Receipt	1,829.81	5,020.90
Financing Expenses	33.06	89.26
SILPA	56.62	1,904.19

Source: Report of local government budget realization.

The next results of the study describe the quantitative performance of the economy in Riau, using the analysis and tabulation of the financial performance figures above to explain the financial capacity of the region. Local taxes contributed the largest portion, 65%, of the Regional Original Revenue in Riau Province in 2017. Local taxes are mandatory contributions to the regions and are collected by the Provincial Government. The income source with the second-largest contribution to the Regional Original Revenue was Other Legitimate Regional Original Revenue, at 25%. This income is derived from the sale of regional assets that are not separated, current accounts, interest income, gains on the difference in rupiah exchange rates against foreign currencies, as well as commissions, discounts, or other forms of income as a result of the sale and/or procurement of goods and/or services by the region.

The average regional fiscal capacity index in Riau Province was 1.2 in 2017, lower than in the previous year when it reached 1.43. The highest index was in Bengkalis Regency with 2.69 (very high category). This is supported by the receipt of Grant Aid Funding *(GAF)* in Bengkalis, the largest in Riau, reaching IDR 2 trillion, which was the result of natural resource sharing.

Meanwhile, the lowest index was in Kuantan Singigi Regency at 0.43, with a very low category. This low index has several causes, such as the small realization of Regional Original Revenue and Grant Aid Funding in 2017, as well as the large personnel expenditure and the poverty rate which reached 9.85%, well above the provincial average of 7.98%. All local governments in Riau Province have regional fiscal health assessment results at a level of 2 or less, as all final scores are in the range of 41-60. The highest score was for the Riau Provincial Government with 57, while the lowest score was 41 in Siak Regency.

Furthermore, the economic potential analysis uses Location Quotient and Klassen Typology. The analysis describes the economic potential in Riau Province using the criteria of business fields or sectors that contribute significantly to Gross Regional Domestic Product (advanced sectors). The results of the LQ analysis show that the agricultural sector is the leading sector with high growth. The Klassen analysis also shows that this sector is advanced and fast-growing, suggesting that this sector can be developed into a leading sector in Riau Province, together with sectors such as the manufacturing sector, which also has decent results from the LQ and Klassen analyses. Specifically, the development of the oil palm agricultural sector, combined with the palm oil processing industry in the downstream sector, can increase the competitiveness of Riau Province through palm oil production.

The descriptive analysis of financial performance and capital expenditure allows a framework of the regional financial capacity to be constructed. The variables of natural resource potential, commodity production capacity, and economic growth are all elements of Gross Regional Domestic Product. This variable is related to the regional financial capability variables, which are reflected in the Regional Revenue and Expenditure Budget *(RREB)*, namely Regional Original Revenue *(ROR)*, Special Allocation Fund *(SAF)*, General Allocation Fund *(GAF)*, and Budget Capital Expenditure *(BCE)*. Thus, an abstraction of the theory of regional economic performance based on natural resources proposes the following major propositions (P1 ...), leading to the framework in Figure 2.

P1: Gross Regional Domestic Product has an impact on the Budget Capital Expenditure for a certain period.

P2: Gross Regional Domestic Product has implications for the nominalization of Regional Original Revenue, as well as the General Special Allocation Fund and the Special Allocation Fund for certain periods.

P3: The Budget Capital Expenditure for a certain period indirectly creates Regional Original Revenue, as well as the General Special Allocation Fund and the Special Allocation Fund for the following period.

P4: The Budget Capital Expenditure for a certain period indirectly increases the Gross Regional Domestic Product of the following period.

P5: Regional Original Revenue, as well as the General Special Allocation Fund and the Special Allocation Fund for a certain period, has an impact on the Budget Capital Expenditure for a certain period.

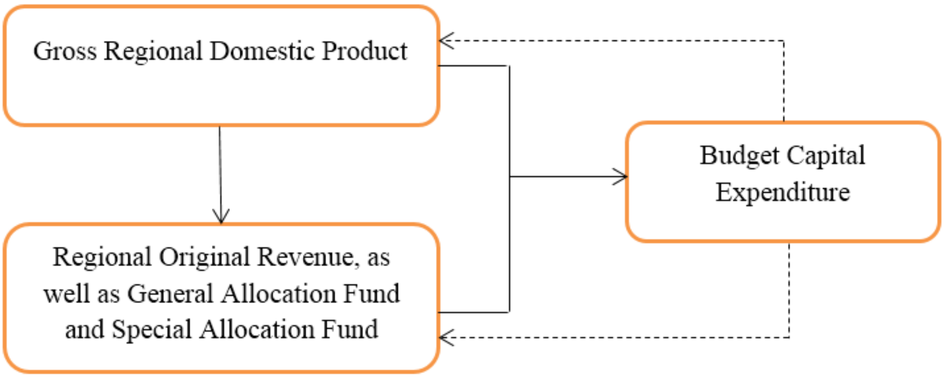

Figure 2. Regional financial capability theory to achieve economic performance.

This framework contributes to the technique of calculating Gross Regional Domestic Product using the production approach proposed by Kuncoro (2015), which is the added value of goods and services by the various production units. That is, the theory of regional financial capacity provides an extension to macroeconomic theory that has not been previously suggested in the literature. The next theoretical contribution is to explain the components of the Regional Revenue and Expenditure Budget and their performance assessment as intended by Nurul Badriyah, in Yustika (2008); Mardiasmo (2002); Sjafrizal (2014); and Isyandi (2009). The variable of the amount of General Allocation Fund *(GAF)* supplied by the government is in line with this approach to solving the regional financial capacity problems (Jhingan, 2014; Sjafrizal, 2018; Yustika, 2008).

This framework shows Budget Capital Expenditure *(BCE)* as the dependent variable; however, it is also an indirect antecedent of Gross Regional Domestic Product and regional income/revenue at a later time. This explains the operationalization of finance details of programs and activities related to plans and the realization of capital costs (Isyandi, 2009; Jhingan, 2014; Priyarsono, 2011; Sjafrizal, 2018). In the context of Riau Province, it is connected to the framework in Figure 1, which is the regional economic growth through the operationalization of the natural resource sector industry.

The economy of Riau Province in 2017, as measured by Gross Regional Domestic Product at constant 2010 prices, reached IDR 471.42 trillion. The economy of Riau grew by 2.71% or an increase of 2.23% compared to the previous year. On the production side, the economic structure of Riau is dominated (74.87%) by three main business fields: Mining and Excavation (25.93%), Processing Industry (25.31%), and Agriculture, Forestry, and

Fisheries (23.63 %). The growth took place in all business fields, with the largest growth in the manufacturing sector (5.51%), followed by the agriculture, forestry, and fisheries sector (5.28%). Meanwhile, the mining and quarrying and financial services sectors experienced contractions of 6.26% and 2.24%, respectively.

These findings confirm the underlying theory of Figure 1 that the potential of natural resources and processed products or commodities is not only oil and gas from mining and quarrying. The natural resources from the agricultural, forestry, and fishery sector and the associated processing industries contribute significantly to Riau's economic growth. Such achievements are possible for other regions in Indonesia; thus, the theory of regional financial capacity to achieve economic performance is universal, as in Figure 2.

In 2017, the economy of Riau Province contributed 5.10% to the national economy with the 5th largest Gross Regional Domestic Product in Indonesia and the largest on the island of Sumatra. The agricultural sector offers good prospects for the economy of Riau Province. Unlike other economic sectors, the agro-economy has not experienced a decline. This means that the agricultural sector is not significantly affected by national or global market turmoil. One reason for this phenomenon is the development of oil palm plantations in Riau Province. The rapid growth of palm oil has triggered the growth of the palm oil management industry of semi-finished materials (Crude Palm Oil - CPO), one of Indonesia's main non-oil and gas export commodities.

Nonetheless, the mining and quarrying sector is a major contributor to the economy of Riau Province and is greatly influenced by global and national economic conditions. This is in accordance with the framework in Figure 1; price fluctuations of external natural resource commodities in world markets have an indirect effect on the Gross Regional Domestic Product. This situation is reflected in the contraction of the mining and quarrying sectors, which recorded minus growth in 2016 and 2017 of minus 4.22% and minus 6.26%, respectively.

Prices and markets for commodity products based on natural resources provide opportunities for future export value, which is expected to increase along with the growth of the agriculture, forestry, and fisheries and processing industry sectors. These sectors have the potential to penetrate the ASEAN and European markets. These opportunities have implications for the most desirable Riau Province government policies to maintain the momentum of economic growth and encourage its development. For example, the economic sectors and activities that absorb labor are relatively high, namely the agriculture, forestry, and fisheries sector, as well as the processing industry. The next area of improvement is government policy regarding the availability of supporting infrastructure for the downstream industry, which is still weak while the inflation rate is high. This is due to fluctuations in the prices of the main commodity, such as foodstuffs, which still depend on other provinces in Indonesia. The direction of government policy for the best management of the economy and the public is in line with that proposed by Sjafrizal (2014).

Nevertheless, the discussion needs to be deepened and expanded again based on the criticism of Trihatmoko and Susilo (2018), who argued that the use of the natural resources of Riau Province has not been able to alleviate the poverty of its people. This statement supports the theory of Sukirno (2006); Sukirno (2005) that if an area is rich in natural resources, its people should be prosperous. The perspective of this discussion reminds us that poverty alleviation does not only mean increasing program funding for the community since population growth factors often add to the number of poor (Sjafrizal, 2018; Tarigan, 2007). Contemporary economic theory, like economic murakabism, or the murakab economic system, allows space for the discussion of any regional economic studies in Indonesia, or any country rich in natural resources (Trihatmoko, 2019; Trihatmoko & Susilo, 2018; Trihatmoko, 2020; Trihatmoko, 2018).

5. CONCLUSION AND RECOMMENDATIONS

Based on the results of this study and their discussion, certain conclusions can be formulated. First, the economic performance of Riau during the period before 2017 was unsatisfactory, showing a decline or worsening trend. This was due to the production balance being supported by the mining and quarrying sector and this sector fluctuating depending on the turmoil of the national and world economy, instead of the decreasing productivity due to the depletion of resources.

Second, the synchronization of the National Revenue and Expenditure Budget *(NREB)* and the Regional Revenue and Expenditure Budget *(RREB)* is still necessary to increase efforts to avoid overlapping and overbudgeting program and development activities. In this regard, more intensive synergy and coordination from stakeholders are required. Furthermore, the dependence on funds from the central government is still high, as can be seen from the higher amount of income transferred into the region compared to the Regional Original Revenue *(ROR)*. Thus, local governments are advised to always strive to increase their Regional Original Revenue *(ROR)* so that their dependence on transferred revenues from the central government can be reduced.

Third, the composition of the expenditure ceiling in the Regional Revenue and Expenditure Budget *(RREB)* of Riau Province is still dominated by Personnel Expenditure, which comprises 38.24% of the total ceiling, followed by Capital Expenditure with 23.26%, Goods and Services Expenditure with 20.68%, Transfer Expenditures to Regions with 8.54%, Grant Expenditures with 5.29%, and the Financial Assistance Expenditure with 3.69%. Given this composition, 38.24% of the Regional Revenue and Expenditure Budget *(RREB)* is used to pay for compulsory personnel expenditure. This high proportion reduces the flexibility of regional governments to allocate funds for expenditures that can increase economic growth. This analysis shows that the fiscal space in Riau Province is still relatively small. The recommendation is that this needs to be enlarged through increased spending efficiency so that it can be used to finance infrastructure capital expenditures, which are very supportive of regional economic activities.

Fourth, all the local government budget allocations in Riau Province apply deficit budget policies when compiling their Regional Revenue and Expenditure Budget *(RREB)*. This means that local governments are budgeting expenditures that exceed their revenue targets to carry out fiscal stimulus efforts, which are expected to stimulate economic growth. However, in reality, the deficit that occurred was not as budgeted but was smaller, and there were even some Regional Governments that experienced a realized surplus.

Furthermore, the general recommendation is that the Regional Government should explore various internal sources of finances to meet the government's financing needs and ensure development in their regions. These should be financed through Regional Original Revenue *(ROR)* and not depend on transfers from the central government. To strengthen the regional economy, the executive and the legislature must together formulate a policy mechanism that is accommodative of the aspirations of the local community, especially the human resources. This can be achieved through innovative employment policies that will make regional economic growth more meaningful.

Regional employment policies also help to improve the quality of services to the community. It is expected that a reduced level of dependence of local governments on the central government, increased professionalism of regional government officials, and regional financial management reforms will spur the realization of an advanced, modern, growing, and developing regional economy that will strengthen the national unity and integrity and welcome in the era of the global economy. To achieve this noble goal, it would be better for the regional and central governments to review the murakabi economic system.

The framework of regional economic performance based on natural resources and the theory of regional financial capacity to achieve economic performance is founded on the analysis of the results of the economic research conducted in Riau Province. An important factor in maintaining the development of regions is to plug the capital flow leaks that can result from a high dependency on imports in production and consumption, the export of dividends and savings elsewhere, and the loss of human capital. Further quantitative research could explore the national economic performance of each region in Indonesia by testing the propositions of this study. Such research can also be conducted in other countries in the context of their regional or national economies.

Funding: This study received no specific financial support.
Competing Interests: The authors declare that they have no competing interests.
Authors' Contributions: Both authors contributed equally to the conception and design of the study.

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