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The effect of fiscal independence and expenditure efficiency on the financial performance of local governments

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ABSTRACT

This study examines how fiscal independence and expenditure efficiency are associated with the financial performance of local governments and develops an integrative mechanism for interpreting their interaction. A structured integrative literature review was conducted using Google Scholar and OpenAlex for literature discovery, supplemented by backward citation chaining and verification of bibliographic metadata through DOI and publisher records. Search terms combined fiscal autonomy, fiscal independence, fiscal decentralization, local/subnational government, expenditure or spending efficiency, financial performance, financial condition, solvency, and sustainability. The analytic corpus comprises 40 peer-reviewed journal articles published between 1994 and 2026; foundational studies were retained when methodologically or theoretically essential, while recent studies were used to assess contemporary relevance. Eligibility required direct relevance to local or subnational government and at least one focal construct. Evidence was extracted into a standardized matrix and synthesized through descriptive mapping, thematic coding, conceptual comparison, and mechanism-based synthesis. The review indicates that fiscal independence is generally associated with greater fiscal flexibility and solvency, but its contribution depends on effective discretionary authority, revenue stability, governance quality, and transfer design. Expenditure efficiency is more directly related to financial performance because it determines how fiscal capacity is converted into service outputs and sustainable budget positions. The synthesis proposes the Integrative Model of Regional Financial Independence-Efficiency-Performance (MIKEK), in which expenditure efficiency functions as a transmission mechanism and institutional, economic, regulatory, demographic, and geographic conditions shape the relationship. The study contributes a transparent framework and identifies priorities for empirical testing in Indonesian local governments.



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Introduction

Fiscal decentralization assigns local governments greater responsibility for mobilizing revenue, allocating expenditure, and sustaining public services. Its expected advantages arise from the proposition that subnational governments possess better information about local preferences and can align public resources more closely with community needs (Oates, 1999). These advantages are conditional rather than automatic because transfer arrangements, tax authority, administrative capacity, and governance quality influence whether additional fiscal space is converted into better outcomes (Faguet, 2014; Gadenne & Singhal, 2014; Martínez-Vázquez et al., 2017).

In Indonesia, decentralization has substantially expanded the fiscal and service-delivery responsibilities of provincial and district/city governments. Earlier evidence shows that decentralization changed subnational spending, taxation, and saving behavior, while more recent work emphasizes persistent differences in fiscal performance across jurisdictions (Smoke & Lewis, 1996; Lewis, 2005; Hummel & Kusumasari, 2026; Wahyudi et al., 2026). The institutional setting has also evolved under Law Number 1 of 2022 on Central and Regional Financial Relations, which changes the design of transfers, local taxation, and performance incentives and therefore provides an important contemporary context for examining regional fiscal capacity (Lewis, 2023).

Fiscal independence is operationalized in this review as the degree to which a local government can finance and influence its public functions using revenue sources under meaningful local control. Common accounting proxies include the ratio of own-source revenue (Pendapatan Asli Daerah/PAD) to total revenue and the ratio of PAD to transfers and borrowing. These measures are useful but should not be interpreted as complete measures of effective autonomy, because a jurisdiction may record substantial own-source revenue while still facing regulatory constraints over tax bases, rates, or expenditure composition (Mauri, 2024). Accordingly, fiscal independence is treated as a multidimensional capacity that combines own-revenue strength, discretionary space, and limited structural dependence on external transfers.

Expenditure efficiency is conceptually distinct from budget absorption. An expenditure-realization ratio describes implementation against the approved budget, but it does not establish whether public services were produced at reasonable cost. Substantive efficiency instead concerns the relationship between fiscal inputs and service outputs or outcomes and may be evaluated through cost-per-output measures or frontier methods such as Data Envelopment Analysis (DEA), Free Disposal Hull (FDH), and stochastic frontier analysis (De Borger & Kerstens, 1996; Afonso & Fernandes, 2008; Narbón-Perpiñá & De Witte, 2018a). This distinction is particularly important in Indonesia because low absorption may reflect delayed implementation rather than efficiency, whereas high absorption may coexist with weak service productivity.

Local government financial performance is likewise treated as a multidimensional construct rather than a single ratio. The literature distinguishes cash solvency, budgetary solvency, long-term solvency, revenue sustainability, debt burden, fiscal flexibility, and the capacity to maintain service levels (Wang et al., 2007; Clark, 2015; Navarro-Galera et al., 2016). A structured review of local-government financial indicators similarly reports substantial diversity in measurement and no universal indicator set, reinforcing the need to interpret multiple dimensions together (Iacuzzi, 2021). More recent evidence also connects financial sustainability with broader local-government capacity to maintain development commitments over time (Bisogno et al., 2024).

Previous studies often examine fiscal autonomy, spending efficiency, and financial condition in separate methodological traditions. Fiscal-autonomy studies focus on revenue authority and transfer dependence; efficiency studies focus on the productivity of public spending; and financial-condition studies focus on solvency, fiscal stress, or sustainability. This fragmentation leaves an explanatory gap: greater fiscal space does not necessarily improve financial performance unless the additional resources are converted into productive and fiscally sustainable expenditure. A synthesis that explicitly connects the three constructs can therefore clarify why jurisdictions with similar revenue structures may experience different financial outcomes.

This study addresses that gap through a structured integrative literature review. It aims to (1) synthesize the association between fiscal independence and local-government financial performance; (2) examine how expenditure efficiency shapes financial performance and sustainability; (3) identify institutional, economic, regulatory, demographic, and geographic conditions that strengthen or weaken these relationships; and (4) develop an integrative conceptual model relevant to Indonesian regional financial management. The contribution is explanatory rather than causal: the study does not estimate new regression coefficients, but integrates heterogeneous empirical and conceptual evidence to formulate a mechanism that can be tested in future panel, frontier-efficiency, or mixed-method research.

Literature Review

Fiscal Independence of Local Governments

Fiscal independence refers to the capacity of local governments to mobilize and meaningfully control own-source revenues and to allocate fiscal resources according to local priorities. It intersects with tax autonomy, revenue autonomy, and expenditure autonomy, but these concepts are not identical. Oates (1999) emphasizes decentralized decision-making close to citizen preferences, while Mauri (2024) demonstrates that accounting shares of subnational revenue or expenditure may overstate effective autonomy when local authorities cannot independently alter tax bases, rates, or expenditure composition. Measurement therefore needs to distinguish formal revenue shares from effective decision-making authority.

In the Indonesian context, regional original income (PAD) is the main proxy of self-revenue capacity. The ratio of PAD to total regional revenue describes the weight of local sources in the income structure, while the

ratio of PAD to transfers and loans emphasizes the degree of dependency. The two ratios do not always produce the same interpretation. This study views fiscal independence as a broader concept than the magnitude of PAD, which is a combination of revenue mobilization capacity, discretionary space, and low structural dependence on external sources.

Theoretically, increasing independence can strengthen hard budget constraints and accountability as local governments face a more direct relationship between revenue collection decisions, service quality, and citizen evaluation. Boetti et al. (2012) found a relationship that supports the role of fiscal autonomy in spending efficiency. Bisogno et al. (2019) show that financial autonomy is positively related to budgetary solvency. However, Iacuzzi et al. (2025) show that these benefits can differ between dimensions of financial health, so fiscal independence needs to be read as a capacity that must be managed, not as an end goal that automatically guarantees performance.

Regional Spending Efficiency

Public sector spending efficiency basically answers the question of how much public output or outcome can be generated from a single unit of resource. This concept is different from budget economics which only assesses low costs and is different from effectiveness which assesses the achievement of goals. Afonso and Fernandes (2008), Balaguer-Coll et al. (2007), and da Cruz and Marques (2014) measure local government efficiency with a frontier approach that compares fiscal inputs with various service outputs. The literature shows that input choices, outputs, estimation methods, and environmental variables can materially change efficiency scores (De Borger & Kerstens, 1996; Aiello & Bonanno, 2019).

For Indonesia's regional financial management, it is important to distinguish two layers of measurement. First, administrative efficiency or budgetary execution, which is reflected, among other things, by the proportion of realization to the budget. Second, substantive efficiency that links expenditure to service outputs and outcomes. A low realization ratio can reflect savings, but it can also indicate program delays, tender failures, weak implementation capacity, or unmet service targets. Therefore, conclusions about efficiency must consider the quality of expenditure and service achievement.

An Indonesian study by Sugiyarto et al. (2025) shows that the spending productivity of disadvantaged regions varies and is influenced by socio-economic factors and grant dependence. This evidence strengthens the argument that transfer design and revenue capacity alone should be considered alongside efficiency. At a broader level, Afonso and Alves (2025) found that spending efficiency can strengthen fiscal sustainability. Thus, efficiency is the main pathway that connects fiscal resources with the quality of the government's financial position.

Financial Performance of Local Governments

The financial performance of local governments is the ability of the government to maintain public services, fulfill obligations, maintain budget balance, and manage resources in a sustainable manner. Wang et al. (2007) divide financial conditions into several solvency dimensions. Zafra-Gómez et al. (2009a) emphasize the need to include service quality and socio-economic conditions so that intergovernmental evaluations are not biased. Clark (2015) emphasized that the validity and reliability of the index are important issues when many ratios are combined in one measure.

The financial sustainability literature expands the focus from the current position to the government's ability to maintain future services and obligations. Navarro-Galera et al. (2016) show that the dimensions of revenue, debt, and services need to be analyzed together. Rodríguez Bolívar et al. (2016, 2021) found that sustainability risks are influenced by budget, demographic, economic, and institutional factors. This means that good financial performance is not just a surplus in one budget year, but rather the capacity to maintain balance, flexibility, solvency, and services over a longer period of time.

In this study, financial performance is positioned as a multidimensional construct that includes: (a) independence and income resilience; (b) budget balance and solvency; (c) liquidity and ability to meet obligations; (d) long-term sustainability; and (e) the ability to maintain service output. This approach prevents performance reductions in a single ratio that can lead to erroneous conclusions.

Conceptual Relationship of Fiscal Independence, Expenditure Efficiency, and Financial Performance

The relationship between fiscal independence and financial performance can be explained through three mechanisms. First, more self-controlled revenues increase the flexibility of local governments to align resources with local priorities. Second, when citizens bear a larger share of local government costs through taxes or levies, fiscal accountability pressures tend to increase. Third, low transfer dependency reduces the risk of changes in central transfer policies to budget sustainability. However, these benefits can be lost if the tax base is narrow, administrative capacity is low, or fiscal authority is only formal.

Spending efficiency serves as a conversion mechanism. Independence creates fiscal space, but efficiency determines whether it produces output, healthy balances, and sustainable services. Local governments with high PAD but rigid, expensive, or unproductive spending may still have weak financial performance. Conversely, regions with limited sources of income can maintain stability if they are able to control costs, prioritize productive spending, and produce high output. These findings are consistent with the literature on value for money, spending efficiency, and financial sustainability (Kalb et al., 2012; Afonso & Alves, 2025).

On that basis, the research proposes a conceptual proposition: P1, stronger fiscal independence tends to support financial performance when accompanied by space for effective discretion and accountability; P2, higher spending efficiency tends to improve performance through resource productivity and fiscal pressure control; P3, spending efficiency is a transmission mechanism that explains why fiscal independence can produce different performance between regions; P4, transfer dependency, economic base, population size, governance quality, and regulatory limits moderate the relationship.

Table 1. Conceptual Operationalization of Research Variables

Variable	Operational definition	Usable indicators/ratios	Interpretation	Methodological notes
Fiscal independence	Capacity of a local government to finance public functions using revenue sources under meaningful local control.	$PAD / \text{Total Revenue} \times 100\%$; alternative: $PAD / (\text{Transfers} + \text{Borrowing}) \times 100\%$; transfer-dependency ratio.	Higher own-source shares generally indicate greater local revenue capacity.	The denominator must be stated explicitly. Accounting ratios do not necessarily equal effective autonomy when tax authority is constrained.
Administrative expenditure execution	Degree to which approved expenditure is implemented within the budget period.	$\text{Actual Expenditure} / \text{Budgeted Expenditure} \times 100\%$.	Shows the pattern of budget execution or absorption.	A low ratio does not automatically indicate efficiency; it may reflect implementation delays or unexecuted programs.
Substantive expenditure efficiency	Ability to produce public-service outputs or outcomes with minimum fiscal inputs.	Service output/Expenditure input; cost per output; DEA/FDH/SFA efficiency score.	Higher frontier efficiency or lower cost per comparable output indicates more productive resource use.	Comparisons should account for demographic, geographic, economic, and service-mandate differences.
Financial performance	Capacity to maintain budget balance, solvency, fiscal flexibility, and sustainable service provision.	Budget balance, cash solvency, long-term solvency, debt burden, PAD growth/stability, fiscal sustainability, service-capacity indicators.	Performance is multidimensional and should not be inferred from a single ratio.	Composite measures require transparent construction, consistency checks, and comparison among reasonably similar jurisdictions.

Method

This study uses a structured integrative literature review with qualitative thematic and mechanism-based synthesis. An integrative design is appropriate when a research question requires the comparison of evidence produced with different methods and measurement frameworks rather than the pooling of a single standardized effect size (Snyder, 2019). Reporting was strengthened using PRISMA 2020 principles of transparency for identification, screening, eligibility, and synthesis, while the review is not presented as a statistical meta-analysis (Page et al., 2021). The unit of analysis is the journal article, and the substantive population of interest is local or subnational government, including municipalities, districts/regencies, cities, and comparable local authorities.

The search was updated through September 30, 2026. Google Scholar and OpenAlex were used for literature discovery, supplemented by backward citation chaining from major reviews and seminal studies and by DOI/publisher metadata checks. Three search strings guided discovery: (S1) ("fiscal autonomy" OR "fiscal independence" OR "fiscal decentralization") AND ("local government" OR municipality OR subnational) AND

("financial performance" OR "financial condition" OR solvency OR sustainability); (S2) ("expenditure efficiency" OR "spending efficiency" OR "public expenditure efficiency") AND ("local government" OR municipality OR subnational) AND (performance OR service OR sustainability); and (S3) ("local government financial condition" OR "fiscal health" OR "financial sustainability") AND (solvency OR efficiency OR autonomy). Search results were screened using title, abstract, and full-text relevance where available.

Articles were included when they were peer-reviewed journal articles; focused on local/subnational government or a directly comparable public-sector unit; addressed at least one focal construct (fiscal independence/decentralization, expenditure efficiency/service productivity, or financial condition/performance/sustainability); provided traceable bibliographic metadata; and contained sufficient theoretical, methodological, or empirical detail for structured extraction. Duplicates, theses/dissertations, non-peer-reviewed proceedings, reports without journal peer review, sources focused only on national government, and items without adequate bibliographic traceability were excluded. The final analytic corpus contains 40 unique journal articles. The corpus size was determined by the bounded eligibility criteria and conceptual coverage rather than statistical power, because the study synthesizes literature rather than estimates a population parameter. Methodological guidance and legal-context sources cited in the manuscript are not counted as part of the 40-article analytic corpus.

Data extraction used a predefined coding matrix containing author and year, country or jurisdiction, government level, research design, observation period or sample where reported, operationalization of the focal construct, analytical method, direction and conditions of the reported relationship, limitations, and relevance to the proposed integrative mechanism. Synthesis proceeded in four stages: bibliographic verification and deduplication; descriptive evidence mapping by year, method, geography, and theme; thematic comparison of convergent, divergent, and conditional findings; and mechanism-based synthesis linking fiscal capacity, expenditure conversion, financial outcomes, and contextual conditions. Because coding was conducted by a single reviewer, an intercoder reliability statistic such as Cohen's kappa was not applicable; this is reported transparently and treated as a limitation rather than replaced by an artificial reliability coefficient.

The 1994–2026 publication window was retained deliberately. Older articles were included only when they provide foundational theory, established efficiency methods, or widely used financial-condition frameworks, while recent studies were used to assess whether those propositions remain relevant under contemporary fiscal arrangements. This approach avoids treating publication recency as a substitute for methodological relevance. The evidence was not weighted solely by journal quartile because quartile assignments vary over time and would systematically disadvantage seminal studies; instead, source quality was assessed through peer-review status, traceable metadata, methodological transparency, and direct relevance to the review questions. Figure 1 summarizes the review workflow, and Table 2 describes the composition of the final corpus.

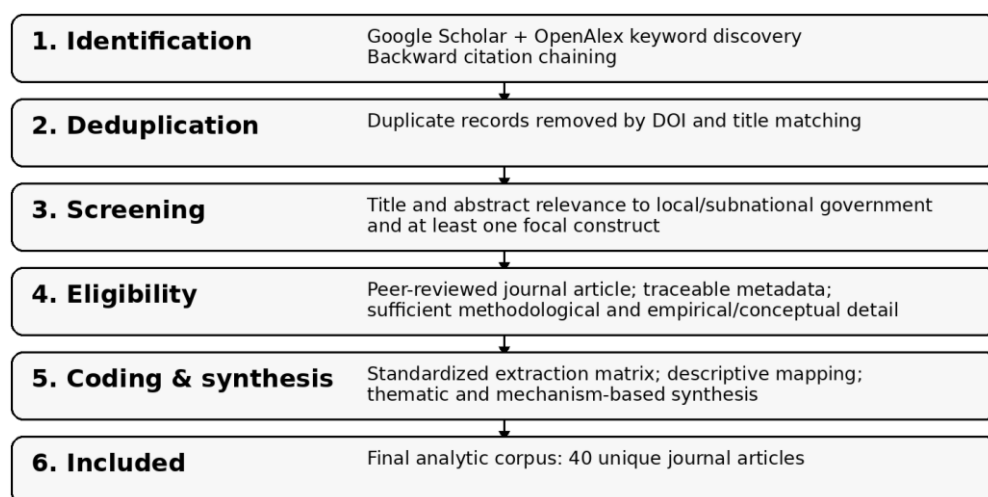


Figure 1. Structured integrative-review workflow

Table 2. Distribution of the 40-Article Analytic Corpus

Dimensions	Category	Quantity	Percentage
Year of publication	1994–2000	4	10.0%
Year of publication	2001–2005	3	7.5%
Year of publication	2006–2010	8	20.0%
Year of publication	2011–2015	9	22.5%

Dimensions	Category	Quantity	Percentage
Year of publication	2016–2020	9	22.5%
Year of publication	2021–2026	7	17.5%
Main methods	Econometric/Panel	15	37.5%
Main methods	Financial Index/Diagnostic	9	22.5%
Main methods	Frontier Efficiency	8	20.0%
Main methods	Review/Conceptual	7	17.5%
Main methods	Institutional/Policy	1	2.5%
Geographic coverage	Indonesia	5	12.5%
Geographic coverage	Europe	21	52.5%
Geographic coverage	United States	6	15.0%
Geographic coverage	Cross-country/global/OECD	8	20.0%
Main theme	Fiscal independence/decentralization	12	30.0%
Main theme	Spending efficiency & service performance	12	30.0%
Main theme	Financial performance/condition/sustainability	16	40.0%

The corpus combines foundational and contemporary evidence across several methodological traditions. Twenty-five of the 40 articles (62.5%) were published from 2011 onward, while seven (17.5%) were published during 2021–2026. The older share is concentrated in seminal work on fiscal federalism, frontier efficiency, and financial-condition measurement. Eight studies explicitly use frontier-efficiency techniques, while others employ panel/econometric models, financial-condition indices, fiscal-distress models, or review/conceptual approaches. European evidence is comparatively prominent because municipal-efficiency and financial-condition research has a long empirical tradition there; five Indonesian articles were retained to preserve institutional relevance. This geographic imbalance is treated as a limitation rather than as evidence that European findings can be transferred mechanically to Indonesia.

Results and Discussions

Literature Evidence Map

The mapping of 40 articles shows three major streams of literature. The first stream discusses fiscal federalism, fiscal decentralization, and fiscal autonomy, which highlights the transfer of authority, self-revenue capabilities, tax incentives, and transfer dependence. The second stream discusses local government efficiency with DEA, FDH, SFA, regression panels, and benchmarking methodologies. The third stream discusses financial condition, fiscal health, budgetary solvency, fiscal distress, and financial sustainability. The three currents are actually interconnected, but often develop in different methodological traditions.

The findings of the review by Narbón-Perpiñá and De Witte (2018a, 2018b) and the meta-study of Aiello and Bonanno (2019) show that efficiency outcomes are highly dependent on input-output definitions and methods. This means that a simple ratio cannot be positioned as a single measure of efficiency. On the other hand, financial condition studies such as Wang et al. (2007), Clark (2015), and Zafra-Gómez et al. (2009a) remind that financial health cannot be simplified into a single indicator. The synthesis of the two literatures yields an important principle: regional financial performance must link sources of revenue, resource utilization, budget position, and ability to maintain services.

Indonesian literature shows a similar pattern. Smoke and Lewis (1996) and Lewis (2005) emphasize institutional capacity and changes in fiscal behavior after decentralization. Hummel and Kusumasari (2026) emphasized that the measure of financial performance must be understood in the context of Indonesia's fiscal federalism. Wahyudi et al. (2026) show that governance capacity is related to revenue effectiveness, efficiency, independence, and sustainability, while Sugiyarto et al. (2025) show variations in the spending efficiency of disadvantaged regions related to structural conditions and grant dependence.

Cross-study comparison also shows that heterogeneity is not random. Studies of intermunicipal cooperation and alternative service-delivery arrangements indicate that organizational form can change the cost-service relationship (Allers & de Greef, 2018; Pérez-López et al., 2015). Research on financial condition emphasizes that similar accounting balances may imply different levels of resilience when debt, liquidity, socioeconomic conditions, and service obligations differ (Brusca et al., 2015; Sohl et al., 2009; Zafra-Gómez et al., 2009b). Political and institutional conditions can further shape sustainability outcomes (Rodríguez Bolívar et al., 2018, 2021). These findings reinforce the need to interpret fiscal independence and spending efficiency within a multidimensional financial-condition framework rather than as isolated ratios.

Fiscal Independence and Financial Performance

In general, the synthesis supports a conditional positive relationship between fiscal independence and financial performance. Regions with a stronger self-income base have more room to set priorities, respond to shocks, and reduce dependence on transfer policies. This strengthens fiscal flexibility and potential solvency. Boetti et al. (2012) show that fiscal autonomy may be related to higher spending efficiency, while Bisogno et al. (2019) found a positive relationship between financial autonomy and budgetary solvency.

However, the relationship is not a mechanical law. Mauri (2024) suggests that measurable autonomy through account structures can differ from effective autonomy. Local governments may record relatively large self-revenue but remain not free to change the base, tariffs, or spending obligations. Iacuzzi et al. (2025) also point out trade-offs between dimensions of financial health: autonomy can help long-term solvency but present challenges to short-term budget liquidity or stability. Thus, PAD increases should not be evaluated separately from revenue volatility, spending liabilities, and cash management capacity.

From a public sector accounting perspective, fiscal independence improves the quality of performance when the source of revenue itself is sustainable, collection costs are reasonable, the tax base does not disrupt the local economy, and additional revenue is allocated to expenditure that generates output. This means that the self-reliance ratio needs to be complemented by PAD growth indicators, PAD stability, tax effort, transfer dependency ratio, and the ability to finance mandatory expenditures and basic services.

For Indonesia, the institutional meaning of fiscal independence also depends on the evolving design of central-local fiscal relations. Lewis (2023) shows that Law Number 1 of 2022 combines changes in local taxation, transfers, earmarking, and performance incentives, illustrating why nominal PAD shares cannot be interpreted independently of regulatory discretion. Recent Indonesian evidence likewise shows that governance capacity is associated with multidimensional fiscal performance and revenue sustainability (Wahyudi et al., 2026). Accordingly, the present review treats fiscal independence as an enabling capacity whose value depends on how effectively the jurisdiction can deploy and sustain that capacity.

Expenditure Efficiency and Financial Performance

Literature evidence on spending efficiency is more consistent in showing the importance of spending productivity to performance. Afonso and Fernandes (2008) show that many local governments can improve performance without increasing spending. Revelli (2010) shows that spending greater than standard does not automatically increase service performance. The findings shift the focus from the question of 'how much spending' to 'what is generated from the spending'.

Efficiency has an impact on financial performance through at least four channels. First, cost savings for the same output improve budget space. Second, greater output from the same input increases value for money. Third, reduced waste reduces financing and debt needs. Fourth, more productive spending strengthens the legitimacy of revenue collection and public support. Afonso and Alves (2025) show more broadly that spending efficiency can improve fiscal sustainability and primary balance.

However, measurements must be cautious. De Borger and Kerstens (1996) and Kalb et al. (2012) show that non-discretionary methods and factors affect efficiency estimation. Archipelagic, mountainous, sparsely populated, or high-service areas may have larger unit costs not because of poor management. Therefore, Indonesia's financial performance benchmarking should classify regions based on comparable characters and avoid highly heterogeneous raw comparisons between regions.

Another implication is that the assessment of the efficiency of the APBD must move from absorption-based assessment to output-based assessment. The ratio of realization to budget is still important to monitor implementation, but it should not be the only basis for calling expenditure efficient. The achievement of minimum service standards, physical output, socio-economic outcomes, and cost per unit of service needs to be juxtaposed with financial data.

The same distinction appears in comparative public-management research: efficiency gains are meaningful only when service levels and quality are considered alongside expenditure. This is consistent with evidence that organizational arrangements, scale, and non-discretionary local conditions influence estimated efficiency (Allers & de Greef, 2018; da Cruz & Marques, 2014; Kalb et al., 2012). Consequently, expenditure efficiency in the MIKEK framework is defined as resource productivity rather than simple underspending, and empirical tests should compare jurisdictions with reasonably similar service responsibilities and structural conditions.

Expenditure Efficiency as a Proposed Transmission Mechanism

The main contribution of this study is to bring together two lines of literature: fiscal autonomy and spending efficiency. Fiscal independence essentially produces 'space' and 'discretion', while efficiency determines the quality of the use of that space. Therefore, fiscal independence can improve performance only when greater

sources of income translate into productive and controlled spending portfolios. This model explains why two regions with the same PAD ratio can have different financial conditions.

Conceptually, the mechanisms are: fiscal independence increases fiscal space and revenue accountability; the space influences the choice of spending composition; the quality of composition and efficiency of implementation determine service outputs as well as cost pressures; ultimately, output, budget balance, liquidity, debt, and flexibility shape financial performance. Transfer dependence, PAD volatility, economic structure, regulation, bureaucratic quality, and population needs can strengthen or weaken each chain.

The model also rejects the assumption that policy targets are to maximize fiscal independence in absolute terms. In regions with small economic bases, transfers remain an important equalization instrument. More realistic goals are self-reliance proportional to local capacity, transfers that do not create negative incentives, and spending that generates value for money. Within this framework, financial performance is the result of a combination of revenue capacity, spending quality, and institutional capacity.

Table 3. Integrative Model of Regional Financial Independence-Efficiency-Performance (MIKEK)

Fiscal Input	Mechanism 1	Mechanism 2	Financial Outcomes	Contextual factors
Fiscal independence: PAD, autonomy, transfer dependency	Fiscal space, flexibility, tax revenue accountability	Spending efficiency: composition, cost per output, productivity, quality of execution	Solvency, budget balance, liquidity, debt capacity, sustainability, service capacity	Governance quality, economic base, regulation, demographics, geography, revenue volatility, transfer design

Implications for Indonesia's Regional Financial Management

For Indonesian local governments, the results of the synthesis lead to five implications. First, the strategy to increase PAD needs to be oriented towards sustainability and tax capacity, not just a nominal increase. Extensification and intensification of revenues must be associated with administrative quality, digitalization, compliance, and impact on local economic activities. Second, central transfers are still needed as an equalization instrument, but their design and use need to drive performance, not strengthen passive dependence.

Third, evaluation of expenditure needs to separate administrative efficiency and substantive efficiency. Very high budget absorption can indicate executionability, but it has not yet proven value for money. In contrast, the rest of the budget does not always show savings. Local governments need to build cost information and unit-cost benchmarking for key services so that the relationship between expenditure and output can be traced.

Fourth, financial performance reporting needs to use a multidimensional dashboard. The ratio of independence, PAD effectiveness, efficiency/absorption, spending growth, operating balance, debt service, current ratio, and sustainability indicators should be interpreted together. This approach is consistent with financial-condition research that rejects dependence on a single ratio (Wang et al., 2007; Clark, 2015) and with structured-review evidence showing that local-government financial indicators serve different purposes and therefore should not be treated as interchangeable (Iacuzzi, 2021). Recent comparative evidence further indicates that financial sustainability is associated with a government's ability to maintain broader development commitments over time (Bisogno et al., 2024).

Fifth, legal and institutional aspects must be placed as part of the analysis, not just as a background. Law Number 1 of 2022 concerning HKPD, Government Regulation Number 12 of 2019, and Permendagri Number 77 of 2020 establish boundaries and procedures for managing revenue and expenditure. With the author's affiliation with the Faculty of Law, this perspective also opens up a cross-disciplinary research agenda between public sector accounting and regional financial law, especially regarding the relationship between fiscal authority design, regulatory compliance, budget discretion, and performance.

Comparison of Key Findings and Research Gap

Table 4. Synthesis of Research Findings, Limitations, and Gaps

Theme	Dominant findings	Limitations of the literature	Indonesia's gap/research agenda
Fiscal independence	It tends to support flexibility, accountability, efficiency, and solvency.	Autonomy measures are often based on accounting ratios and	Build an effective self-reliance index that includes tax discretion, sustainability PAD, and transfer dependence.

Theme	Dominant findings	Limitations of the literature	Indonesia's gap/research agenda
Spending efficiency	Spending more doesn't automatically increase output; productivity and composition determine performance.	do not capture regulatory boundaries. Comparison scores prone to bias due to geography, demographics, and service mandates.	Use DEA/SFA or cost-per-output with homogeneous peer groups and service output data.
Financial performance	Financial conditions are multidimensional: cash, budget, debt, flexibility, sustainability, services.	Some studies still use one/two ratios and short periods.	Build a composite financial performance that is validated and tested across regional types.
Integrative relationships	Autonomy creates space; efficiency translates space into performance.	Studies that test all three constructs simultaneously are still limited.	Mediation/moderation model test: independence → efficiency → performance, moderated governance and transfer dependence.

Limitations and Future Research

This review has four principal limitations. First, the evidence base is heterogeneous in the definition and measurement of fiscal independence, expenditure efficiency, and financial performance, so the synthesis cannot be interpreted as a pooled causal effect. Second, European municipal studies are overrepresented relative to Indonesian studies, which limits direct institutional generalization. Third, the review relies on journal articles with traceable metadata and does not attempt to exhaustively incorporate grey literature, government reports, or unpublished studies; publication bias therefore remains possible. Fourth, the screening and coding were conducted by a single reviewer, so no intercoder reliability statistic was calculated. These limitations are reported explicitly to define the appropriate scope of the conclusions.

Future research should test the proposed MIKEK mechanism with Indonesian provincial and district/city data using designs appropriate to the question, such as multi-year panel models for fiscal relationships, DEA/SFA for expenditure efficiency, and mediation or structural-equation approaches only when their assumptions and data structure are satisfied. Comparative analyses should also stratify jurisdictions by fiscal capacity, geography, service mandate, and transfer dependence. A multi-coder update of the review with exported database records and complete screening logs would allow formal inter-rater reliability assessment and a fully quantified PRISMA flow in a subsequent study.

Conclusions

This structured integrative review shows that fiscal independence and expenditure efficiency are closely related to local-government financial performance, but the relationships are conditional and should not be interpreted as universal causal effects. Greater own-source capacity can expand fiscal flexibility and reduce dependence on external transfers, yet its contribution to solvency and sustainability depends on effective discretionary authority, revenue stability, governance capacity, and the expenditure obligations faced by each jurisdiction. Expenditure efficiency provides the clearest conceptual bridge between fiscal capacity and financial outcomes. The evidence consistently indicates that higher spending or higher budget absorption does not by itself demonstrate better performance. What matters is the ability to convert fiscal inputs into comparable service outputs and outcomes while preserving budget balance, liquidity, debt capacity, and long-term service continuity. For this reason, administrative budget execution and substantive resource productivity should be assessed separately. The main conceptual contribution is the Integrative Model of Regional Financial Independence-Efficiency-Performance (MIKEK). The model was developed through cross-study coding of three evidence streams—fiscal autonomy/decentralization, local-government expenditure efficiency, and financial condition/sustainability—and by tracing the recurring mechanism linking fiscal space to expenditure composition and execution, then to multidimensional financial outcomes. Expenditure efficiency is therefore proposed as a transmission mechanism, while transfer dependence, economic base, governance quality, regulation, demographics, geography, and revenue volatility operate as contextual conditions that may strengthen or weaken the mechanism. For Indonesian regional financial management, the model implies that policy assessment should move beyond a single independence or absorption ratio toward a dashboard that combines revenue autonomy, transfer dependence, expenditure productivity, solvency, fiscal flexibility, and service capacity. The framework is intended as a testable synthesis rather than a substitute for primary empirical analysis; its next step is validation

with multi-year Indonesian local-government data and efficiency measures that explicitly account for structural differences among jurisdictions.

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