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# Determinants of Local Government Financial Independence: A Literature Review

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**ABSTRACT**

This study aims to examine the determinants of local government financial independence in Indonesia by synthesizing empirical evidence from recent studies published between 2021 and 2025. Local government financial independence is a key objective of fiscal decentralization, reflecting the ability of regional governments to finance public services and development activities through locally generated revenue while reducing dependence on central government transfers. This study focuses on five main determinants frequently discussed in the literature, namely local taxes, investment, government size, population, and intergovernmental transfers. A narrative literature review approach is employed to analyze and compare findings from fifteen selected empirical studies that investigate these variables across different regional contexts in Indonesia. The results indicate that local taxes consistently have a positive and significant effect on financial independence, highlighting their importance as a sustainable source of local revenue. Intergovernmental transfers are also found to support financial independence in the short term. In contrast, the effects of investment, government size, and population remain mixed and context-dependent, suggesting the influence of governance quality, demographic structure, and regional characteristics. This study contributes to the literature by providing an integrated understanding of recent findings and identifying research gaps that may guide future empirical research and policy formulation aimed at strengthening local government financial independence.

**Keywords** *Local Government Financial Independence, Fiscal Decentralization, Local Taxes, Intergovernmental Transfers*

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## INTRODUCTION

Local government financial independence refers to the ability of regional governments to generate and manage their own-source revenues and reduce dependence on central government transfers or external borrowing (Purnama, 2016). Achieving financial independence is a central objective of regional autonomy, which grants local governments the authority, responsibility, and discretion to regulate and manage public affairs in accordance with prevailing laws and regulations. Through decentralization, the central government provides opportunities for local governments to independently manage and finance governmental operations and public services (Sari, 2023). Financial independence is expected to enable local governments to better understand regional conditions and respond more effectively to community needs than the central government.

In managing regional finances, local governments are expected to uphold principles of accountability and transparency to ensure responsible use of public funds and strengthen public trust. Fiscal decentralization also provides local governments with the opportunity to optimize local tax policies in a fair manner, aimed at improving public welfare without disadvantaging any party. The success of regional autonomy is influenced by various factors, including human resources capacity, natural resources, financial capability, managerial competence, and socio-cultural conditions. However, empirical evidence indicates that many regions in Indonesia have not yet achieved adequate financial independence.

National audit reports reveal persistent fiscal dependence among local governments. In 2019, most districts and municipalities in eastern Indonesia remained financially dependent, while only a limited number of regions in Java achieved relatively high levels of financial independence. The Indonesian Supreme Audit Institution (BPK RI) reported that in 2020, 443 out of 503 local governments (88.07%) were categorized as having low financial independence, with only 2% considered financially independent. Similar patterns continued in subsequent years, with many regions relying heavily on central government transfers to finance their operations.

This study is grounded in stewardship theory, which emphasizes a trust-based relationship between stewards (government officials) and principals (the public) in achieving organizational goals (Donaldson & Davis, 1991). In the public sector context, stewardship theory assumes that government officials are committed to prioritizing collective welfare and acting in the best interests of society (Secchi, 2017; Anton, 2010). Accordingly, financial independence reflects the government's capacity to responsibly manage public resources for sustainable development and improved public services.

This literature review aims to synthesize and critically examine prior empirical studies on the determinants of local government financial independence, with particular attention to the roles of local taxes, investment, government size, population, and intergovernmental fiscal transfers. The review highlights patterns, theoretical explanations, and inconsistencies in previous findings to identify key research gaps and methodological limitations in the existing literature. By consolidating diverse empirical evidence, this article provides a structured understanding of how fiscal, economic, and demographic factors influence financial independence in local governments, thereby offering a conceptual foundation for future empirical research and policy formulation in the context of fiscal decentralization.

## RESEARCH METHOD

This study employs a qualitative research design using a narrative literature review approach to examine the determinants of local government financial independence in Indonesia. The review focuses on empirical studies published between 2021 and 2025 to ensure the relevance and timeliness of the findings. Articles were selected based on predetermined criteria, including relevance to local government financial independence, empirical analysis, and the use of variables such as local taxes, investment, government size, population, and intergovernmental transfers. The sources of data include national and regional academic journals, conference proceedings, and institutional publications accessed through academic databases and university repositories. A total of fifteen studies that met the inclusion criteria were systematically reviewed and analyzed.

The data analysis process involved content analysis and thematic synthesis. Each selected article was examined to identify research objectives, methodologies, variables, and key findings. The results were then grouped based on major determinants of financial independence to facilitate comparison and interpretation. Differences and similarities across studies were analyzed to identify consistent patterns as well as conflicting results. This approach allows for a comprehensive understanding of the current state of research while highlighting gaps in the literature. By synthesizing recent empirical evidence, this study provides a structured foundation for future quantitative research and supports policymakers in designing strategies to enhance local government financial independence.

## RESULT AND DISCUSSION

### Article Description

The studies summarized in Table 1 highlight recent empirical evidence (2021–2025) on the determinants of local government financial independence in Indonesia. Several studies consistently demonstrate the crucial role of local revenue sources, particularly local taxes, in strengthening financial independence. Research by Siagian (2022), Dewantoro (2022), Rahayu (2024), and Sulistyawati (2024) finds that local taxes have a positive and significant effect on local government financial independence, indicating that higher locally generated revenue reduces dependence on central government transfers. In addition, Afiah (2021) shows that regional investment can significantly enhance financial independence, suggesting that effective investment policies may expand the local economic base and increase revenue capacity. These findings emphasize the importance of optimizing local revenue mobilization and investment management to support fiscal autonomy.

However, the literature also reveals mixed and sometimes contradictory findings regarding other determinants. Government size shows inconsistent effects, as Rofiq (2021) and Sabono (2024) report a negative relationship with financial independence, while Amanda (2024) finds a positive effect, suggesting that asset ownership alone does not guarantee fiscal autonomy without efficient management. Population-related variables also yield divergent results, with some studies reporting positive effects (Susilowati, 2023) and others indicating negative impacts (Alvi, 2023; Humaira, 2025), reflecting differences in demographic structure and fiscal capacity across regions. Furthermore, intergovernmental transfers are found to positively influence financial independence in several studies (Handraini, 2024; Syafri, 2024), although such dependence may undermine long-term fiscal autonomy. Overall, these inconsistencies highlight the need for further research to clarify how fiscal, demographic, and structural factors interact in shaping local government financial independence.

**Table 1.**
**Article Description**

| No. | Author(s) | Year | Title | Research Findings |
|---|---|---|---|---|
| 1 | Nunuy Nur Afiah | 2021 | Regional Investment and E-Government and Their Implications for Local Government Financial Independence | Regional investment has a significant effect on local government financial independence. |
| 2 | Inul Rofiq | 2021 | The Effect of Government Size, Government Age, Government Status, Population, Number of Regional Work Units, Personnel Expenditure, and Leverage on Local Government Financial Independence | Government size has a negative effect on local government financial independence. |
| 3 | Aprillia | 2022 | The Effect of Local Taxes, | Local taxes have a |

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|---|---|---|---|---|
| | Rumondang Siagian | | Local Retribution, and Separated Regional Wealth Management on Financial Independence in West Java | significant effect on local government financial independence. |
| 4 | Dimas Ariyo Dewantoro | 2022 | The Effect of Local Taxes and Local Retribution on Local Government Financial Independence | Local taxes positively and significantly affect financial independence. |
| 5 | Muhammad Raihanul Alvi | 2023 | The Effect of Leverage, Population, and Government Age on Local Government Financial Performance | Population has a negative effect on local government financial performance. |
| 6 | Adellia Susilowati | 2023 | The Effect of Economic Growth, Regional Expenditure, Population, and Regional Investment on Financial Independence in East Kalimantan | Population positively affects local government financial independence. |
| 7 | Winarni Rahayu | 2024 | The Effect of Local Taxes, Revenue Sharing Funds, and Special Allocation Funds on Local Government Financial Independence in Riau Province | Local taxes positively and significantly affect financial independence. |
| 8 | Ardiani Ika Sulistyawati | 2024 | An Empirical Study of Determinants of Local Government Financial Independence | Local taxes positively and significantly affect financial independence. |
| 9 | Valentina Febria Eka Amanda | 2024 | Determinants of Local Government Financial Independence | Government size positively affects financial independence; investment has no significant effect. |
| 10 | Bella Gita Sabono | 2024 | The Effect of Infrastructure and Government Size on Local Government Financial Independence in Maluku Province | Government size negatively affects financial independence. |
| 11 | Totoh Abdulfatah | 2024 | The Effect of GRDP per Capita, Investment, and Capital Expenditure on | Investment has no significant relationship with |

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|---|---|---|---|---|
| | | | Financial Independence in West Java | financial independence. |
| 12 | Helti Handraini | 2024 | The Effect of Local Revenue and Intergovernmental Transfers on Financial Independence in Pasaman Barat | Intergovernmental transfers positively and significantly affect financial independence. |
| 13 | Riza Aditya Syafri | 2024 | Determinants of Local Government Financial Independence in Indonesia | Intergovernmental transfers have a positive and significant effect on financial independence. |
| 14 | Shafa Humaira | 2025 | The Effect of Local Revenue, Economic Growth, and Population on Financial Independence | Population negatively affects local government financial independence. |
| 15 | Muhammad Fairuz Ihsan | 2025 | The Effect of Investment and Capital Expenditure on Local Revenue with Poverty as an Intervening Variable | Investment negatively and significantly affects poverty levels. |

**Local Taxes and Financial Independence**

Empirical evidence from recent studies consistently confirms the pivotal role of local taxes in strengthening local government financial independence. Research by Siagian (2022), Dewantoro (2022), Rahayu (2024), and Sulistyawati (2024) demonstrates that local taxes have a positive and significant impact on financial independence across various Indonesian regions. This finding aligns with fiscal decentralization theory, which emphasizes the importance of locally generated revenue in reducing dependence on central government transfers. Local taxes represent a direct contribution from residents and local economic actors, making them a sustainable revenue source that reflects regional economic activity. Effective tax administration enhances revenue predictability and allows local governments to finance public services and development programs independently.

Furthermore, strong local tax performance may also reflect institutional capacity and governance quality. Regions that successfully optimize tax collection often possess better administrative systems, higher compliance levels, and stronger accountability mechanisms. These conditions support stewardship theory, where government officials act in the public interest by efficiently managing resources entrusted by citizens. However, reliance on local taxes also requires careful policy design to avoid excessive tax burdens that could hinder economic growth. Therefore, while local taxes significantly contribute to financial independence, their effectiveness depends on balanced tax policies, administrative efficiency, and continuous efforts to broaden the local tax base.

**Investment and Financial Independence**

The relationship between investment and local government financial independence remains inconclusive, as reflected in mixed empirical findings. Afiah (2021) reports that regional investment significantly enhances financial independence, suggesting that investment can stimulate economic activity, increase employment, and ultimately expand the local tax base. Investment-driven economic growth may increase local revenue through higher business activity, property values, and consumption, thereby strengthening fiscal capacity. From this perspective, investment functions as a long-term catalyst for improving regional financial sustainability.

In contrast, studies by Abdulfatah (2024) and Amanda (2024) find no significant effect of investment on financial independence. This discrepancy may be attributed to differences in investment types, measurement approaches, and time horizons. Investments in infrastructure or long-term projects often require extended periods before generating measurable fiscal returns. Additionally, weak coordination between investment planning and revenue strategies may limit the ability of local governments to convert investment inflows into increased local revenue. These findings indicate that investment alone is insufficient to enhance financial independence unless accompanied by effective governance, supportive regulatory frameworks, and strategic integration with regional development policies.

**Government Size and Financial Independence**

Studies examining the impact of government size on financial independence reveal inconsistent results. Rofiq (2021) and Sabono (2024) find that larger government size, measured by total assets, negatively affects financial independence. This suggests that asset accumulation may increase operational and maintenance costs, placing pressure on regional budgets and limiting fiscal flexibility. Inefficient asset utilization and weak asset management systems may also reduce the potential contribution of government assets to revenue generation, thereby undermining financial independence.

Conversely, Amanda (2024) reports a positive relationship between government size and financial independence, indicating that larger asset bases may enhance fiscal capacity when managed effectively. Productive assets can support service delivery, attract investment, and generate non-tax revenue.

These contrasting findings highlight that government size alone does not determine financial independence; rather, the effectiveness of asset management and governance quality plays a critical role. Local governments with strong managerial capabilities may leverage their assets to improve fiscal outcomes, while those with poor governance may experience increased fiscal burdens. This underscores the importance of asset optimization strategies in achieving sustainable financial independence.

**Population, Intergovernmental Transfers, and Financial Independence**

The influence of population on local government financial independence varies across studies, reflecting regional demographic diversity. Susilowati (2023) finds that population size positively affects financial independence, suggesting that a larger population can expand the tax base and stimulate economic activity. A productive population may increase local revenue through higher labor participation and consumption. However, Alvi (2023) and Humaira (2025) report negative effects, indicating that population growth may increase public service demands and fiscal burdens, particularly in regions with high dependency ratios. These findings imply that demographic structure, rather than population size alone, is critical in shaping fiscal outcomes.

Intergovernmental transfers are consistently found to positively affect financial independence in the short term (Handraini, 2024; Syafri, 2024). Transfers provide essential fiscal support for regions with limited revenue capacity, enabling them to maintain public services and development programs. However, excessive reliance on transfers may discourage local revenue mobilization and weaken long-term fiscal autonomy. While transfers are necessary to address regional disparities, they should be complemented by policies that encourage local governments to enhance their own-source revenue to achieve sustainable financial independence.

## CONCLUSION

This study reviews recent empirical evidence on the determinants of local government financial independence in Indonesia and highlights several important insights. The findings consistently demonstrate that local taxes are a key driver of financial independence, as they represent a sustainable source of locally generated revenue and reduce reliance on central government transfers. Effective tax administration and balanced tax policies are therefore essential for strengthening fiscal autonomy and supporting the objectives of fiscal decentralization. In addition, intergovernmental transfers are shown to play a significant role in supporting regional fiscal capacity, particularly for regions with limited revenue bases, although excessive dependence on these transfers may undermine long-term financial independence.

However, the effects of investment, government size, and population remain mixed across studies. Investment does not always translate into improved financial independence, particularly when governance capacity, policy integration, and time-lag effects are not adequately addressed. Similarly, government size and population can either enhance or constrain financial independence depending on asset management efficiency, demographic structure, and regional economic conditions. These mixed findings indicate that financial independence cannot be achieved through a single policy instrument but requires a comprehensive approach that integrates revenue optimization, efficient expenditure management, and effective governance. Future research should focus on exploring institutional quality, expenditure efficiency, and regional heterogeneity to better explain variations in local government financial independence and to support more targeted and sustainable fiscal policies.

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