

**THE IMPACT OF REGIONAL ORIGINAL INCOME, BALANCING FUNDS, AND FISCAL STRESS ON CAPITAL EXPENDITURES AND REGIONAL GOVERNMENT FINANCIAL PERFORMANCE**

**Fergisa Rindang Primadi<sup>1</sup>, Wirmie Eka Putra<sup>2</sup>, Muhammad Gowon<sup>3</sup>**

Universitas Jambi, Indonesia<sup>1,2,3</sup>

Email: fergisarindang97@gmail.com

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**ABSTRACT**

Over the last few years, the financial performance of district/city governments in Jambi province has decreased. This condition can be seen from the regional financial independence which is still very low. Therefore, this research aims to analyze more deeply the influence of local revenue, balancing funds, and fiscal stress on regional government financial performance, both direct and indirect influences through capital expenditure. This research is quantitative descriptive. The research was conducted in all districts/cities in Jambi province and used secondary data. Data was obtained through the BPK-RI Jambi Province Representative page in the form of audited regional government financial reports with an observation period from 2017-2022. The data analysis method uses the path analysis method. The study's findings demonstrate that original revenue that is largely generated locally and balancing funds have a major and favorable impact on capital spending. Capital spending is not significantly impacted by fiscal stress. The financial performance of local governments is not significantly impacted by local revenue or fiscal strain. The financial performance of local governments is significantly and negatively impacted by partly balancing funds. The financial performance of local governments is positively and significantly impacted by capital expenditures. Additionally, it was shown that capital spending might moderate the impact of balancing budgets on the financial performance of local governments. But, capital spending does not mitigate the impact of local revenue and fiscal strain on the financial performance of local governments. This research has implications for formulating policies to increase local original income, determining the allocation of capital expenditure and improving the financial performance of regional governments in districts/cities in Jambi province.

**INTRODUCTION**

The ability to oversee their own regional finances is one of the powers granted to regions in the implementation of regional autonomy. The capacity of an area to best manage its natural resource, human resource, and financial resource potentials is a key indicator of good financial management in regional governments (Putri & Amanah, 2020). Measuring the regional financial performance itself allows one to assess the effectiveness of regional financial management (Halim & Kusufi, 2012).

Based on the results of an examination carried out by the BPK-RI representative of Jambi province on regional government financial reports from nine districts and two cities, the average regional financial performance has decreased. The city of Jambi has fiscal independence with an average of 32.09 percent in the low category, while fiscal dependence is

73.74 percent in the medium category. This means that regions have the ability to implement regional autonomy. Other areas, namely Bungo district at 14.03 percent, Kerinci district at 6.85 percent, Merangin district at 8.24 percent, Muaro Jambi district at 7.93 percent, Sorolangun district at 7.68 percent, Tanjung Jabung Barat district at 8.52 percent, East Tanjung Jabung district at 5.96 percent, Tebo district at 8.11 percent, Batanghari district at 9.60 percent and Sungai Full city at 6.14 percent, with fiscal independence in the very low category. This means that regions are not yet able to independently implement regional autonomy and are still dependent on the central government (Sarumaha & Annisa, 2020).

Regional government financial reports show that the average regional dependence on the central government is very high. Bungo district at 85.28 percent, Kerinci district at 89.90 percent, Merangin district at 89.31 percent, Muaro Jambi district at 90.35 percent, Sorolangun district at 90.53 percent, Tanjung Jabung Barat district at 90.08 percent, East Tanjung Jabung district at 92.86 percent, Tebo district at 89.18 percent, Batanghari district at 88.53 percent and Sungai Full city at 92.78 percent, with fiscal dependence in the high category. This condition shows that a decline has occurred in the financial performance of regional governments. In a situation like this, it is hoped that local governments can increase potential regional income sources, especially from local original income. The greater the potential source of regional income generated, the higher the regional financial independence and will have an impact on improving regional financial performance (Sulo, 2023).

Numerous prior studies have looked at municipal governments' financial performance. Nonetheless, a number of study findings present disparate findings. Research explicitly analyzing the financial performance of district/city administrations in the province of Jambi is still scarce. Actually, research such as this is crucial to the planning and development of initiatives aimed at enhancing the financial performance of local governments in the province of Jambi. This study is urgently carried out considering that the results of the 2020 central government financial report determined that of the ten provinces on the island of Sumatra, one of the provinces whose fiscal independence status was in the not yet independent category was Jambi province ([www.cnnindonesia.com](http://www.cnnindonesia.com), 2024). It is intended that this study would aid in the creation of policies that will hasten the financial performance improvements of Jambi Province's district and city administrations. This entails optimizing local original income and other regional revenue streams, maintaining cash reserves, formulating financial stress-reduction plans, and having the capacity to spend capital expenditure wisely.

Regional original income has a significant influence on local government financial performance (Suharlian et al., 2024; Putri & Yuniarta, 2023; and Putri & Ratnawati, 2023). Original Regional Income is one of the main sources of regional income. Original regional income will be used to finance various government expenditures, including capital expenditures which have an impact on increasing regional income. In other words, high local original income indicates a high level of financial resource capability of a region which will later improve the financial performance of the regional government.

Apart from local original income, balancing funds actually have a good impact and are able to trigger improvements in regional government financial performance. Several studies have found a significant influence of balancing funds on local government financial

performance (Azzahro et al., 2024); (Maulina et al., 2021); and (Armaja et al., 2017). Transfers from the central government in the form of balancing funds are the main source of regional financial strength in financing regional spending, especially for regions that have a relatively low level of independence. Therefore, increasing balancing funds that are well managed by the regions will play a very important role in encouraging infrastructure development, which will have an impact on good services and community welfare.

The final factor that has a significant influence on local government financial performance is fiscal stress (Sulo, 2023); Tehupuring, 2021; (Oktaviana et al., 2017). Fiscal stress is budget (fiscal) pressure that occurs as a result of limited regional revenues (Arnett, 2011), decreased economic growth or recession, industrial decline resulting in reduced tax revenues and the role of bureaucratic inefficiency, corruption, high salaries for employees and high expenditure. (Shamsub & Akoto (2004), the realization of income targets that have not been achieved (Oktaviana et al., 2017), and the region's inability to pay current obligations (Hevesi, 2006). When fiscal stress is high, regions tend to maximize their original regional revenue potential and this will have an impact on improving the financial performance of local governments.

If the economic infrastructure is sufficient, local governments' financial performance can be improved. In this scenario, enhancing the financial performance of local governments would be influenced by economic infrastructure, which includes capital investments in buildings and structures, machinery and equipment, roads, bridges, irrigation systems, and networks. Local governments' financial performance will be improved by capital spending that is properly allocated and managed by the government (Sinaga et al., 2023; (Niswani & Firdaus, 2022). Good infrastructure may boost community production, foster efficiency across a range of industries, and ultimately boost welfare growth for the community (Andirfa et al., 2016).

Research on the financial performance of regional governments must continue, particularly in places like the districts and cities in the province of Jambi where financial independence is still relatively low. The purpose of this study is to provide a more thorough analysis of the direct and indirect effects of capital expenditures, local revenue, balancing finances, and fiscal stress on the financial performance of regional governments. This research is urgent for at least two reasons: (1) there is currently a dearth of studies that expressly look at the financial performance of district/city regional administrations in the province of Jambi. (2) Because regional financial independence is quite low, research that can help Jambi province's regional governments operate better financially is needed. This research is expected to contribute to formulating policies to increase local revenue, managing balance funds, making policies when fiscal stress occurs and being able to allocate capital expenditure appropriately.

## **RESEARCH METHODS**

This study employs quantitative methods. Local revenue, balancing funds, and fiscal stress are the independent factors examined in this study; capital expenditure is the intervening variable; and the dependent variable is the financial performance of the regional government. Bungo Regency, Kerinci Regency, Merangin Regency, Muaro Jambi Regency, Sarolangun Regency, West Tanjung Jabung Regency, East Tanjung Jabung Regency, Tebo Regency, Batanghari Regency, Jambi City, and Sungai City were the regencies/cities in the Jambi province where the research was carried out. The Republic of Indonesia's Financial

Audit Agency (BPK) provided secondary data for this study. Representative of Jambi Province, which was accessed via the website [www.jambi.bpk.go.id](http://www.jambi.bpk.go.id).

Path analysis is employed in the data analysis process. The multiple linear regression analysis approach gave rise to the analytical technique known as path analysis, which allows one to examine both the direct and indirect effects of postulated variables. The Eviews 12.0 program was utilized for data analysis in this investigation. The traditional assumption test, which includes the heteroscedasticity, multicollinearity, and normality tests, is the first step in the data analysis process. The next step of the analytical process is choosing the panel data regression model and doing hypothesis testing if the outcomes of the traditional assumption test show no issues.

A route analysis test and a partial significance test (t test) are the two components of hypothesis testing. The purpose of the t test is to evaluate the independent variable's partial impact on the dependent variable. If the t test's significance probability value is less than 0.05, the independent variable is said to have a significant impact on the dependent variable. On the other hand, it may be said that the independent variable has no significant impact on the dependent variable if the significance probability value of the t test is greater than 0.05. The purpose of the path analysis test is to determine if the capital expenditure variable is appropriate for mediating the link between the dependent and independent variables. The capital expenditure variable is declared capable of mediating the relationship between the independent variable and the dependent variable if the indirect influence is greater than the direct influence, and conversely if the indirect influence is smaller than the direct influence, then the capital expenditure variable is declared not to mediate the relationship between the independent variable and the dependent variable.

The model that will be analyzed in this research can be written as follows:

The following hypotheses will be investigated in this study: (1) Original regional income has a significant impact on capital expenditure; (2) Balancing funds have a significant impact on capital expenditure; (3) Fiscal stress has a significant impact on capital expenditure; (4) Original regional income has a significant impact on local governments' financial performance; (5) Balancing funds have a significant impact on local governments' financial performance; and (6) Fiscal stress has a significant impact on local governments' financial performance. (7) Capital expenditures have a major impact on local governments' financial performance; (8) Capital expenditures act as a mediator between the impact of local government income and the financial performance of regional governments, (9) Capital expenditure mediates the influence of balancing funds on regional government financial performance, (10) Capital expenditure mediates the influence of fiscal stress on regional government financial performance.

## RESULTS AND DISCUSSION

### Classical assumption testing

The classical assumption test was carried out on both research models. Classic assumption tests include normality tests, multicollinearity tests, and heteroscedasticity tests. A summary of the test results is presented in Table 1.

**Table 1**  
**Summary of Normality Test Results**

Influence	Probability	Results
Model 1	p= 0.69	Normality Assumption Fulfilled (Prob. > 0.05)
Model 2	p= 0.48	Normality Assumption Fulfilled (Prob. > 0.05)

Source: Processed data (2024)

Table 1 shows the probability values for Model 1 and Model 2 are greater than 0.05. This shows that the data for both research models is normally distributed.

**Table 2**  
**Summary of Multicollinearity Test Results**

Variable	Model 1	Model 2	Information
	VIF	VIF	
Locally-generated revenue	1.08	1.18	Multicollinearity does not occur
Balancing fund	1.19	1.38	Multicollinearity does not occur
Fiscal stress	1.28	1.31	Multicollinearity does not occur
Capital expenditure		1.25	Multicollinearity does not occur

Source: Processed data (2024)

Table 2 shows that the VIF values for all independent variables in Model 1 and Model 2 are smaller than 10. This shows that there is no multicollinearity in the two research models.

**Table 3**  
**Summary of Heteroscedasticity Test Results**

Influence	Breusch-Pagan	Results
Model 1	p= 0.38	Heteroscedasticity Does Not Occur, Prob. > 0.05
Model 2	p= 0.46	Heteroscedasticity Does Not Occur, Prob. > 0.05

Source: Processed data (2024)

Table 3 shows the Breusch-Pagan values for all independent variables in Model 1 and Model 2 are greater than 0.05. This shows that there is no multicollinearity in the two research models.

**Table 4**  
**Summary of Model Selection Test Results**

Model/Test	Model 1	Model 2
CEM vs FEM	FEM	FEM
REM vs FEM	BRAKE	BRAKE
The final result	BRAKE	CEM

Source: Processed data (2024)

Table 4 shows that the best model for equation I is using the Random Effect Model. Meanwhile, the best model for equation II is to use the Common Effect Model.

**Hypothesis test**

Model 1 examines how capital spending is impacted by fiscal stress, balancing funds, and regional original income (PAD). Model 2 examines the impact of capital spending, fiscal stress, balancing finances, and PAD on the financial performance of local governments. Table 5 presents an overview of the findings from the regression analysis of the two study models. The Model 1 analysis's findings suggest that fiscal hardship by itself has no influence on capital spending. In the meanwhile, capital spending is significantly and somewhat positively impacted by PAD and balancing finances. Based on the probability value of the importance of financial stress, which was found to be higher than 0.05 ( $0.280 > 0.05$ ), this was inferred, while the probability value of the significance of the PAD and balancing fund variables was smaller than 0.05. Based on the results of this test, the first and second hypotheses are accepted. Meanwhile the third hypothesis is rejected.

**Table 5**  
**Summary of Regression Analysis Results**

Variable	Model 1		Model 2	
	B	Sig.	B	Sig.
Locally-generated revenue	0.119	0.018	-0.016	0.108
Balancing fund	0.478	0.003	-0.096	0.003
Fiscal stress	-0.031	0.280	0.005	0.368
Capital expenditure			0.072	0.003
R Square		0.198		0.192
Adjusted R Square		0.159		0.139
F-Stats		5,108		3,627
Probs (F-Stats)		0.003		0.010

Source: Processed data (2024)

The financial performance of regional governments is significantly impacted by capital expenditures and balancing finances, according to the Model 2 estimation results. Fiscal hardship and PAD, however, have a little impact on the financial performance of local governments. Based on the regression coefficient value and significant likelihood of the t test that come from Model 2 estimate, as shown in Table 5, this conclusion has been drawn. coefficient of regression Regression coefficient for the balancing fund is negative (-0.096), and the significance probability value is less than 0.05 ( $0.003 < 0.05$ ). The capital expenditure has a significant probability value of less than 0.05 ( $0.003 < 0.05$ ) and a positive regression coefficient (0.072). With a significant probability value of  $0.108 > 0.05$ , PAD has a negative sign (-0.016). Meanwhile, fiscal stress has a positive regression coefficient (0.005) with a significance probability value greater than 0.05 ( $0.368 > 0.05$ ). Based on the estimation results of Model 2, the fourth and sixth hypotheses are rejected, while the fifth and seventh hypotheses are accepted.

**Sobel Test testing**

The Influence of Regional Original Income on Regional Government Financial Performance with Capital Expenditures as an Intervening Variable.

Calculating with Sobel Test:

$$Sab = \sqrt{b^2 Sa1^2 + a1^2 Sb^2 + Sa1^2 Sb^2}$$

$$\begin{aligned}
 &= \sqrt{(0,073)^2(0,049)^2 + (0,119)^2(0,024)^2 + (0,049)^2(0,024)^2} \\
 &= \sqrt{(0,005)x(0,002) + (0,014)x(0,001) + (0,002)x(0,001)} \\
 &= \sqrt{0,0000127 + 0,0000080 + 0,0000014} \\
 &= \sqrt{0,000022} = 0,005
 \end{aligned}$$

Calculating the t-count value:

$$\begin{aligned}
 t &= \frac{ab}{Sab} \\
 &= \frac{(0,119)x(0,073)}{0,005} \\
 &= \frac{0,009}{0,005} \\
 &= 1,83
 \end{aligned}$$

The computation results show that the t-count is 1.83, which is less than the t-table of 1.96. Therefore, it can be said that capital expenditures cannot act as a mediator between the impact of local revenue and the financial performance of regional governments.

The Effect of Balancing Funds on Regional Government Financial Performance with Capital Expenditures as an Intervening Variable.

Calculating with Sobel Test:

$$\begin{aligned}
 Sab &= \sqrt{b^2Sa2^2 + a2^2Sb^2 + Sa2^2Sb^2} \\
 &= \sqrt{(0,073)^2(0,154)^2 + (0,478)^2(0,024)^2 + (0,154)^2(0,024)^2} \\
 &= \sqrt{(0,005)x(0,024) + (0,228)x(0,001) + (0,024)x(0,001)} \\
 &= \sqrt{0,0001244 + 0,0001301 + 0,0000135} \\
 &= \sqrt{0,000268} = 0,016
 \end{aligned}$$

Calculating the t-count value:

$$\begin{aligned}
 t &= \frac{ab}{Sab} \\
 &= \frac{(0,478)x(0,073)}{0,016} \\
 &= \frac{0,035}{0,016} \\
 &= 2,12
 \end{aligned}$$

It may be inferred from the computation results that capital expenditure has the ability to mediate the influence of balancing finances on regional government financial performance since the t-count is 2.12, which is more than the t-table of 1.96.

The Effect of Fiscal Stress on Regional Government Financial Performance with Capital Expenditures as an Intervening Variable.

Calculating with Sobel Test:

$$\begin{aligned}
 Sab &= \sqrt{b^2Sa3^2 + a3^2Sb^2 + Sa3^2Sb^2} \\
 &= \sqrt{(0,073)^2(0,029)^2 + (-0,031)^2(0,024)^2 + (0,029)^2(0,024)^2} \\
 &= \sqrt{(0,0053)x(0,0008) + (0,0010)x(0,0006) + (0,0008)x(0,0006)} \\
 &= \sqrt{0,00000431 + 0,00000055 + 0,00000047} \\
 &= \sqrt{0,0000053} = 0,002
 \end{aligned}$$

Calculating the t-count value:

$$\begin{aligned}
 t &= \frac{ab}{Sab} \\
 &= \frac{(-0,0312)x(0,0726)}{0,016} \\
 &= \frac{-0,0023}{0,0023} \\
 &= -0,98
 \end{aligned}$$

It may be inferred from the computation results that capital expenditure is unable to mediate the effect of fiscal stress on local government financial performance since the t-count is -0.98, which is less than the t-table of 1.96.

## Discussion

### The Effect of Regional Original Income on Capital Expenditures

The results of the analysis show that local revenue has a positive and significant influence on capital expenditure. The results of this research are in line with research by (Ikhyanuddin & Safitri, 2022); Putri et al., (2021); and Riany et al., (2019). The large potential of original regional income obtained by districts/cities in Jambi province shows that the regional government has worked optimally to explore its own regional potential so that it is able to make a very significant contribution to the capital expenditure allocation. If the regional government wants to increase capital expenditure for public services and community welfare, then the regional government must explore the potential that exists in the region as much as possible. The greater the regional original income obtained, the more likely it is that the region can meet its own spending needs, without having to depend on the central government.

### The Effect of Balancing Funds on Capital Expenditures

The results of the analysis show that balancing funds have a significant positive influence on capital expenditure. The results of this research are in line with research by Sinaga et al., (2023); (Hermawan et al., 2021); and (Malau & Parapat, 2020). Balancing funds are transfers from the central government to regions which aim to cover disparities that occur between regions. Regional governments can use balancing funds to enhance public services, which benefits undercapitalized areas, provided that the funds are managed properly and in compliance with the laws. Balancing funds are the primary source of regional funding for government implementation in regions with low levels of financial independence aside from initial regional income, particularly in regional spending, both capital and routine.

### The Influence of Fiscal Stress Has an Influence on Fashion Shopping

The analysis's findings indicate that capital spending is not significantly impacted by fiscal hardship. The findings of this study are consistent with those of studies by Rossy (2013), Wulandari & Fauzihardani (2022), and (Dewi & Suprihati, 2021). This implies that the regional government keeps up capital expenditures even in times of financial strain. In times of fiscal strain on regional governments, the latter are compelled to maximize their domestic revenue streams in order to allocate a greater share of their spending to public services or infrastructure improvements that facilitate faster regional economic growth, which is accomplished through capital expenditures.

## **The Influence of Original Regional Income on Regional Government Financial Performance**

The results of the analysis show that local original income does not have a significant influence on local government financial performance. The results of this research are in line with research by Kumolo et al., (2023); Mukhibad & Aji (2020); and (Aslindar & Hapsari, 2022). Even though original regional income in regencies/cities in Jambi Province is categorized as effective, there are still regencies/cities in Jambi Province whose original regional income has not reached the targets set in the preparation of the APBD. Meanwhile, although the target that has been achieved by the region is high, it has not been able to make a large contribution to regional income. The low portion given by PAD to regional income indicates that regional governments must do their best to explore the potential of the main regional revenue sources so that regions are able to be financially independent and will have an impact on improving regional government financial performance.

## **The Effect of Balancing Funds on Regional Government Financial Performance**

The analysis's findings demonstrate that balancing funds significantly impair local governments' ability to manage their finances. The findings of this study are consistent with those of studies conducted by (Maulina et al., 2021), (Armaja et al., 2017), and (Azzahro et al., 2024). The substantial amount of balancing money that the province of Jambi's regencies and cities receive demonstrates how reliant regional administrations are on balancing funds. To clarify, a higher amount of balancing funds received by the region signifies a decline in the financial performance of the regional government, whilst a smaller amount of balancing funds shows a reduced reliance on balancing funds by the regional government.

## **The Effect of Fiscal Stress on Regional Government Financial Performance**

The analysis's findings demonstrate that the financial performance of local governments is not significantly impacted by fiscal hardship. The findings of this study are consistent with those of studies conducted in 2019 by Prasetyo & Rahayu, (Anggraeni & Kiswanto, 2018), and (Fadhli et al., 2023). Liquidity ratio-based fiscal stress measurement has not been able to demonstrate a connection between fiscal stress and local government financial performance. The typical district or city in the province of Jambi has been able to meet its present financial responsibilities, but it has not been able to influence how well the government has managed its finances or distributed its budget for regional development. This is because, when regional governments experience fiscal pressure, the regions have anticipated it by issuing policies in accordance with their respective regional government regulations to overcome fiscal pressure.

## **The Influence of Capital Expenditures on Regional Government Financial Performance**

The analysis's findings demonstrate that capital spending significantly improves the financial performance of local governments. The findings of this study are consistent with those of (Niswani & Firdaus, 2022). Additionally, (Anggreni et al., 2018) and (Andirfa et al., 2016) complement this research. Capital expenditure allocation will assist regions in obtaining financial resources from their potential, which may subsequently support regional revenue development and improve the performance of regional governments. With the availability of good infrastructure, efficiency can be created in various sectors and society's productivity will become higher and in time there can be an increase in welfare growth.

## **The Influence of Regional Original Income on Regional Government Financial Performance through Capital Expenditures**

The analysis's findings demonstrate that capital spending is unable to mitigate the impact of local revenue on the financial performance of the government. This is due to the fact that the first regional income still generates very little regional revenue. Because of the low amount of original regional income, regional administrations are hesitant to fund capital projects using money from their own original revenue. Therefore, transfer funds from the center in the form of balancing funds are increasingly important for regional capital expenditures. The financial performance of local governments is impacted by this. Effectiveness of regional government will also rise if local governments employ local money in a way that is appropriate for its proportions.

## **The Effect of Balancing Funds on Regional Government Financial Performance Through Capital Expenditures**

The results of the analysis show that capital expenditure successfully mediates the effect of balancing funds on government financial performance. Regional governments that are able to manage balancing funds without any element of personal interest in the allocation will provide an increase in the allocation of capital expenditure. Because balancing funds are distributed for equal distribution due to disparities between regions. Balancing funds that are well managed and distributed to capital expenditure and used for development for the welfare of the community will increase economic growth in the region and have an impact on improving the financial performance of regional governments.

## **The Effect of Fiscal Stress on Regional Government Financial Performance Through Capital Expenditures**

The analysis's findings demonstrate that capital spending is unable to mitigate the impact of fiscal stress on the financial performance of the government. Local governments are expected to be able to effectively deploy their resources, especially through productive capital spending, in times of financial strain. Effective capital spending, including building public infrastructure and facilities, should be able to boost local economic growth and enhance community services. Policies adopted by the region must be able to address the financial predicament faced by regional governments without endangering the community. With the existence of regional policies in overcoming fiscal pressures, it is hoped that regions will maximize potential sources of original regional income which will later be used as a source of financing for regional expenditure and as a source of increasing regional assets.

## **CONCLUSION**

Several inferences have been drawn from the analysis's findings, including the fact that regional original revenue and balancing funds significantly and favorably influence capital spending. Capital spending is not significantly impacted by fiscal stress. The financial performance of local governments is not significantly impacted by local revenue or fiscal strain. The financial performance of local governments is significantly and negatively impacted by partly balancing funds. The financial performance of local governments is positively and significantly impacted by capital expenditures. Additionally, it was shown that capital spending

might moderate the impact of balancing budgets on the financial performance of regional governments. On the other hand, capital spending has no moderating effect on the impact of local revenue and fiscal strain on the financial performance of local governments. The province of Jambi's district and city governments are encouraged by this research to investigate and optimize the potential of their respective areas in the fields of agriculture, tourism, and marine and fisheries. They are also encouraged to strengthen capital expenditure by giving infrastructure development top priority in order to support economic growth. The findings of this study will have an impact on capital expenditure allocation, policy formulation to boost PAD, and regional financial independence, all of which will enhance the province of Jambi's district and city regional governments' financial performance.

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