International Journal of
Economics Development Research, Volume 6(6), 2025
pp. 4012-4026

Local Government Investment in Financial Performance: Evidence from Local Government in Indonesia

Suci Deliya Natasya[1], Mustamin[2], Andi Chairil Furqan[3], Tenripada[4]

Abstract:

Indonesia's national development goals focus not only on improving social welfare but also on creating an inclusive and sustainable investment climate. This study aims to analyze the influence of regional financial performance on regional investment levels in Indonesia, with a focus on financial independence and flexibility. This study uses quantitative methods. The data used covers 420 provinces/regencies/cities in 2021 and 2022 with a total of 840 observations, which were analyzed using multiple linear regression. The results show that regional financial independence has a positive and significant effect on investment levels, reflecting the region's ability to manage resources independently. Regional financial flexibility also has a positive and significant effect, with the ability to adjust budgets that support sustainable development and investment. The results of this study indicate that the combination of financial independence and flexibility creates a sustainable investment climate, especially in the fields of foreign direct investment (FDI) and domestic direct investment (DDI). The implications of this study demonstrate the importance of adaptive and transparent regional financial management to increase investment attractiveness and accelerate regional economic growth in Indonesia. This study has limitations in the scope of variables that only cover two financial performance indicators out of six available indicators, as well as limited data until 2022. Future studies are recommended to add other relevant variables such as human resource quality, risk management index, political stability and infrastructure, as well as conduct longitudinal analysis with annual data and a cross-regional approach among developing countries.

Keywords: *Domestic Direct Investment, Financial Performance, Foreign Direct Investment, Financial Flexibility*

Submitted: September 30, 2025, Accepted: November 3, 2025, Published: November 10, 2025

1. Introduction

National development goals not only include improving social welfare, but also emphasize the importance of creating an inclusive and sustainable investment climate throughout Indonesia (Nadzir & Kenda, 2023). Investment is one of the main

[1] *Department of Accounting, Tadulako University, Palu, Indonesia, sucideliya195@gmail.com*
[2] *Department of Accounting, Tadulako University, Palu, Indonesia*
[3] *Department of Accounting, Tadulako University, Palu, Indonesia*
[4] *Department of Accounting, Tadulako University, Palu, Indonesia*

components in driving economic growth, job creation, and accelerating regional development. Indonesia experienced a significant increase in investment realization, both in terms of foreign direct investment (FDI) and domestic direct investment (DDI), in the first quarter of 2022, FDI and DDI showed growth of 25.1% and 31.8% respectively, in contrast to the same period the previous year, but this achievement is not entirely equitable. Based on the national investment realization report, there are differences in investment levels between regions, where some regions have not experienced significant increases, even showing a decline in the second to fourth quarters, this inequality continues to this day, Based on the report of the Ministry of Investment/BKP in the third quarter of 2025, national investment realization reached IDR 491.4 trillion, an increase of around 16% compared to the same period the previous year. Of this amount, Domestic Direct Investment (FDI) of IDR 279.4 trillion exceeded Foreign Direct Investment (FDI) of IDR 212 trillion, indicating the increasingly strong role of national business actors in driving economic growth (Hilirisasi/BKPM, 2025). However, investment distribution is still concentrated in several regions such as West Java, DKI Jakarta, and East Java, while most regions outside Java recorded much lower investment values , indicating that the increase in national investment does not fully reflect equality between regions. One of the main causes of this condition is the difference in fiscal capacity and financial flexibility of local governments. This condition shows that investment success is not only influenced by national macro factors, but also by internal regional factors such as regional financial performance (Ika, 2009). A report from the Directorate General of Fiscal Balance (DJPK), revealed that the majority of local governments in Indonesia remain highly dependent on transfer funds from the central government, with more than half of regions having a fiscal independence ratio below 30%. This low fiscal capacity and budget flexibility limit the ability of local governments to provide adequate economic infrastructure and investment incentives.

Regional financial performance is an important element that can strengthen regional incentives to attract investment, both from abroad and domestically. Good financial performance will be better able to provide economic infrastructure, quality public services, and incentives that can create a stable and sustainable investment climate (Suryanta, 2019). Regional government financial performance can be measured through various indicators, one of which is based on the Regulation of the Minister of Home Affairs (Permendagri) Number 19 of 2020 which includes: (1) Financial independence, (2) Financial flexibility, (3) Operational solvency, (4) Short-term solvency, (5) Long-term solvency, (6) Service solvency.

In this context, regional financial independence and regional financial flexibility are two fundamental elements that can encourage and attract investment, both from abroad and domestically (Nurliza & Halmawati, 2020). Financial independence indicates the extent to which a region is able to independently finance development activities and public services by optimizing local revenue (PAD), without high dependence on central transfer funds (Suci & Asmara., 2014). Regions with strong financial performance will be better able to provide economic infrastructure, quality public services, and competitive fiscal incentives (Zulvan & Purbasari, 2024). Regional financial flexibility plays a crucial role in ensuring that local governments can adapt their expenditure structures to the dynamics of economic development (Handraini et al., 2024). High budget flexibility allows local governments to shift spending from the consumptive sector to the productive sector, such as capital expenditure, which directly contributes to infrastructure development and improved public services to encourage the development of a favorable investment environment. Research by Fransisco et al., (2016) shows that local governments with flexible spending structures are able to capture investment opportunities, meet private sector needs, and accelerate the development of strategic areas. Overall, the combination of regional financial independence and high financial flexibility not only creates a healthy, transparent, and competitive investment climate, but can also be a key strategy in encouraging equitable investment and realizing inclusive and sustainable regional economic growth.

Several studies conducted by Amanda & Murwiati, (2025) & Syafri et al., (2024) found that improving regional financial performance has a positive impact on economic expansion and investment. Furthermore, this is supported by Setianto & Kusumaputra, (2017) who stated that financial flexibility increases investment capacity. In line with these findings, Arslan-Ayaydin et al., (2014) & Balcilar et al., (2015) emphasized the importance of a strong financial sector in increasing investment, especially during crises and in regions with a low investment climate. Furthermore, Rosidin & Saputra, (2020) & Warman & Arza, (2024) strengthened the argument that economic growth and regional financial performance play an important role in encouraging fiscal independence and sustainable investment. This phenomenon and several previous studies have created a gap that must be filled through this research, although many studies show that regional financial performance is correlated with economic growth and the investment climate Amanda & Murwiati, (2025); Syafri et al., (2024); Setianto & Kusumaputra, (2017), however, there is still limited research that simultaneously examines two main dimensions of financial performance, namely regional financial independence and regional financial flexibility as determinants of regional investment levels, especially in foreign direct investment (FDI) and domestic direct investment (DDI) across regional governments in Indonesia. Therefore, this study aims to: (1) analyze the effect of regional financial independence on regional investment levels; and (2) analyze the effect(of fiscal flexibility on regional investment levels. These two objectives are tested separately for FDI and DDI to capture the behavior of foreign and domestic investors.

To answer the research questions above, this study uses local government data in Indonesia covering 542 provinces/districts/cities, with a total of 420 observations. The analysis was conducted using multiple linear regression methods to examine the effect of financial performance on regional investment levels. The findings in this study indicate several important things. **First,** regional financial independence has a positive and significant effect on regional investment levels, which reflects that regions with independent resource management capacity and stable fiscal policies are able to attract investment and strengthen economic growth. **Second,** regional financial flexibility through adaptive capacity in adjusting budget allocations from consumptive to productive spending shows a significant positive effect, indicating that responsive budget management can encourage investment inflows and support the sustainability of regional development. This study makes an important contribution in filling the existing literature gap, especially regarding the role of regional financial performance through regional financial independence and flexibility in driving investment levels. Although a number of previous studies have identified the importance of financial independence and flexibility in driving regional development. This study presents a novelty by integrating two key dimensions of regional financial performance through financial independence and flexibility into a single empirical analysis model of regional investment levels, specifically in foreign direct investment (FDI) and domestic direct investment (DDI). Furthermore, this study brings a new perspective by using comprehensive data across provinces/regencies/cities in Indonesia over a broad time span, thereby providing a more representative picture of differences in regional fiscal capacity in attracting investment. This approach is expected to enrich the empirical literature on the role of regional financial performance in creating inclusive economic growth and sustainable development. These findings also provide practical policy implications, especially for regional governments in optimizing regional financial management with a focus on increasing independent fiscal capacity and adaptive and transparent budget management. This approach is crucial for creating a conducive investment climate, accelerating development, and ensuring that economic benefits can be felt evenly throughout Indonesia.

2. Theoretical Background

Fiscal Decentralization Theory: The theory of fiscal decentralization, developed by Oates, (2005), explains that the delegation of fiscal authority from the central government to regional governments can increase the efficiency and effectiveness of public financial management. This is reinforced and emphasized by Law of the Republic of Indonesia Number 23 of 2014 concerning Regional Government. In this regard, decentralization allows regional governments to manage their own revenues and regulate expenditure policies according to regional needs and characteristics. This is believed to encourage accountability, increase responsiveness, and expand the fiscal policy space of regional governments. Fiscal decentralization is realized through increased regional financial independence and flexibility in budget management (Nurliza & Halmawati, 2020). Regions that are able to finance their own needs without high dependence on the central government have a greater capacity to meet investment needs. Research by Rosidin & Saputra, (2020) shows that regions with a high level of fiscal independence have a more stable fiscal capacity and are more attractive to investors because they are perceived to have lower fiscal risk. Furthermore, Syafri et al., (2024) stated that fiscal flexibility allows local governments to adjust spending to economic dynamics and strategic development needs, including attracting investment. Research conducted by Arini & Kusuma, (2019) shows that increasing regional original revenue (PAD) and capital expenditure have a positive and significant impact on the realization of private investment in Indonesia. These results indicate that regional fiscal capacity and public spending efficiency play a crucial role in strengthening investment flows at the regional level. These findings align with the principles of fiscal decentralization theory, which emphasizes that fiscal autonomy through regional financial independence and flexibility can create a healthy, competitive, and sustainable investment climate.

Stakeholder Theory: Stakeholder theory explains that public organizations are not solely accountable to one entity (the central government), but also to all parties who have an interest in or are affected by the organization's activities (Freeman & McVea, 2005). In this regard, local governments, as managers of public finances, must consider the interests of stakeholders (the public, investors, the central government, and regulatory agencies) in every decision-making process. This is in line with Deegan, (2002) view that pressure from stakeholders drives public organizations to increase transparency and accountability to maintain public legitimacy. Therefore, local fiscal strategies should focus not only on internal efficiency but also on building investor confidence through open and accountable financial governance. Therefore, this theory reinforces the view that independent and flexible fiscal policy is a response to stakeholder demands for sustainable and public-oriented economic development.

The Effect of Regional Financial Independence on Regional Investment Levels: Regional independence can be defined as a region's ability to manage various government affairs independently, using financing derived from regional original revenue (PAD) (Afiah et al., 2021). A study by Suci & Asmara., (2014) shows that regions with a high proportion of PAD have broader fiscal space and a lower level of dependence on central transfers, reflecting fiscal stability. Furthermore, Zulvan & Purbasari, (2024) demonstrate that regional fiscal independence can stimulate economic growth by providing broader fiscal space for development financing, thereby increasing the attractiveness of regional investment. Research by Halawa et al., (2025) shows that the effectiveness of fiscal decentralization policies and the ability of regions to independently manage PAD contribute to economic growth and regional fiscal stability. This is in line with the view that regions with a high level of fiscal independence tend to have more stable fiscal conditions, thereby increasing investor confidence in the continuity of public policies. Therefore, based on the literature, it is suspected that regional financial independence plays a role in increasing regional investment levels.**H1**: Regional financial independence has a significant positive effect on the level of regional investment

The Effect of Regional Financial Flexibility on Regional Investment Levels: Regional financial flexibility reflects the ability of local governments to adapt their financial structures to changing development needs and economic conditions. (Arslan-Ayaydin et al., 2014) state that fiscal flexibility helps maintain investment continuity amidst challenging fiscal conditions, with the region's ability to balance routine and capital expenditures, thus ensuring investment continuity. Studies by Setianto & Kusumaputra, (2017) and Kanoli et al., (2023) revealed that regions with high levels of budget flexibility are able to accelerate development and increase investor confidence through efficient and accountable budget management. Furthermore, Wu et al., (2024) found that high fiscal flexibility increases the efficiency of public investment and strengthens responses to economic uncertainty. Thus, financial flexibility enables local governments to maintain the continuity of investment programs and enhance investor attractiveness. **H2:** Regional financial flexibility has a significant positive effect on regional investment levels.

In addition to their individual effects, regional financial independence and flexibility also have the potential to interact with each other in influencing investment decisions. Financial independence provides a strong and stable fiscal foundation for regional governments through the ability to independently finance development activities, and financial flexibility provides adaptive capacity to changing economic conditions and development dynamics. The interaction between these two aspects creates a stable and responsive fiscal system, where financial independence increases regional capacity to finance investment policies sustainably, while fiscal flexibility allows for strategic adjustments to economic priorities and market conditions. Both not only strengthen regional fiscal capacity but also increase investor confidence in the stability of public policy and the sustainability of regional development programs. Thus, the synergy between regional financial independence and flexibility is expected to collectively accelerate investment realization and strengthen regional economic competitiveness

3. Methodology

Data: This study uses a quantitative method to empirically examine how regional financial performance affects regional investment levels (foreign investment and domestic investment). The sample was selected using a purposive sampling method. This study utilized secondary data from 542 Indonesian provincial/district/city governments in 2021 and 2022. However, 122 regencies and cities had neither foreign direct investment (FDI) nor domestic direct investment (DDI), and were therefore excluded from the study sample. Consequently, due to the lack of adequate data, the final sample size was set at 420 provinces/districts/cities, or approximately 77.49 percent of the total provinces/districts/cities in Indonesia in one observation year. Since the data used covered two years of observation, 840 observations constituted the final sample. Each data used in this study is sourced from Indonesian government agencies, namely from the Ministry of Investment/Investment Coordinating Board (BKPM) for regional investment level data published in the Investment Realization Report, data related to Financial Independence and Financial Flexibility from the Ministry of Finance of the Republic of Indonesia through the Directorate General of Financial Balance (DJPK), age, geographic location and HDI data come from the Ministry of Finance of the Interior which records the year of formation of each regional government.

Empirical Operational Model and Variables: To answer the research questions and test the hypotheses, the empirical model in this study is as follows:

$PMA_{it} = \beta0 + \beta1fiscal_{it} + \beta2flexibility_{it} + \beta3Ages_{it} + \beta4Island_{it} + \beta5HDI_{it} + e_{it}$ (1)
$PMDN_{it} = \beta0 + \beta1fical_{it} + \beta2flexibility_{it} + \beta3Ages_{it} + \beta4Island_{it} + \beta5HDI_{it} + e_{it}$ (2

The variables in this study are PMA_{it}, $PMDN_{it}$, $fiscal_{it}$, $flekskeu_{it}$, $Ages_{it}$, $Island_{it}$, Hdi_{it}. PMA_{it}, $PMDN_{it}$ are variables used to measure the level of regional investment and assess the ability of a region to attract and absorb capital flows from the domestic and foreign sectors to encourage economic growth and regional development as measured by two indicators, namely: Domestic Direct Investment (DDI) and Foreign Direct Investment (FDI). Fiscal independence is the ability of a regional government to finance regional government activities independently without relying on external assistance, including the central government, which is measured by regional original income (PAD) divided by total income, a high ratio indicates the independence of a region and a low ratio indicates that the region has not been categorized as independent. Financial Flexibility is a condition in which local governments can increase financial resources to face increased commitments, through increased revenue or increased debt capacity, which is measured by total revenue minus special allocation funds (DAK) then divided by total liabilities added to employee expenses, a high ratio indicates that local governments have sufficient fiscal space to manage finances independently and adaptively, and a low ratio indicates fiscal limitations and high dependence on routine expenditures and financial obligations.

Ages, Island, Hdi are control variables in this study measured using the natural logarithm (Ln) of total asset value, ages which is the ages variable of the Regional Government in 2021-2022 measured using the number of years of establishment of the regional government. Island is a variable of the geographical location of the regional government measured using a dummy, namely "1" if the regional government is on the island of Java, and "0" if it is outside the island of Java. Hdi, is a human development index used to represent the level of human development in a region measured based on the average of three main dimensions, namely health (life expectancy), education (average years of schooling and expected years of schooling), and standard of living (per capita income).

Table 1. Operationalization of Variables and Data Sources

Nama	Operasionalisasi Variabel	Sumber Data
PMA_{it},	Regional investment is measured by Foreign Direct Investment (FDI)	Ministry of Investment/BKPM
$PMDN_{it}$	Regional investment is measured by Domestic Direct Investment (DDI)	Ministry of Investment/BKPM
$Fiscal_{it}$	Regional financial independence is measured by regional original income divided by total income.	Directorate General of Fiscal Balance (DJPK)).
$Flexibility_{it}$	Financial flexibility is measured by total revenue minus special allocation funds (DAK) then divided by total liabilities plus employee expenses.	Directorate General of Fiscal Balance (DJPK)
$Ages_{it}$	Age of Government	Ministry of Internal Affairs.
$Island_{it}$	Geographical location of the Regional Government	Ministry of Internal Affairs..

4. Empirical Findings/Result

Descriptive Statistics and Variable Correlation: Descriptive testing is the initial stage of quantitative data analysis that aims to describe the basic characteristics of research variables, such as the mean, standard deviation, minimum, and maximum values. This test is not used to test hypotheses, but rather to understand general patterns in the data.

Table 2. Descriptive Statistics of Variables

Information	Mean	Std Dev	Min	Max
FDI_{it}*	2.165	8.522	0	111,667
DDI_{it}*	184	667	0	8,922
$Fiscal_{it}$	15.36	12.88	0.35	80.39
$Flexibility_{it}$	2.36	0.75	0.92	9
$Ages_{it}$	46.42	23.48	7	71
$Island_{it}$	0.24	0.43	0	1
Hdi_{it}	70.82	5.05	56.13	87.18
Information: Number of observations = 840				
****) In billions of Rupiah***				
*****) In Thousands of Rupiah***				

Source: Output STATA-17 (2025)

Table 2 explains the descriptive statistics for all variables analyzed in this study. The average Foreign Direct Investment (FDI) variable shows a value of 2.165 billion rupiah with a standard deviation of 8.522 billion rupiah, which means that foreign investment received by local governments is at a high level, with the highest value of 111.667 billion rupiah and the lowest 0 rupiah, which indicates that not all regions have the same ability to attract foreign investment. The average Domestic Direct Investment (DDI) variable is 184 thousand rupiah with a standard deviation of 667 thousand rupiah, indicating that domestic investment in the region is at a moderate level. With the highest value of 8,922 thousand rupiah and 0 rupiah as the lowest value, indicating differences in the distribution of domestic investment, where most are still concentrated in more developed regions. The average Regional Fiscal Independence variable is 15.36 indicating that the majority of local governments in the sample still have a relatively low level of fiscal independence. The standard deviation value of 12.88, with a minimum of 0.35 and a maximum of 80.39, indicates differences in fiscal capacity between local governments. The average value of the Regional Financial Flexibility variable was recorded at 2.36, with a standard deviation of 0.75, indicating that the average local government's ability to manage budgets flexibly is still relatively limited. The range of minimum values from 0.92 to a maximum of 9 indicates that only a small proportion of areas have high budget maneuverability capacity.

Related the control variables, the $Ages_{it}$ variable has an average of 46.42, meaning that the average age of the sampled city government is around 46 years old. This indicates that most areas have been established for a fairly long time, with a standard deviation of 23.48, and a minimum value of 7 and a maximum value of 71, indicating a wide age range between areas. The $Island_{it}$ variable has an average of 0.24, indicating that most of the sample comes from areas outside Java, with a deviation of 0.43, a minimum value of 0, and a maximum value of 1. The Hdi_{it} variable has an average value of 70.83, indicating that the average human development index of the regions in this study is relatively high. The standard deviation of 5.05, and a minimum value of 56.13 and a maximum value of 87.18, indicate that there is inequality in the quality of human development between regions.

Correlation analysis of variables: A correlation test is a statistical method for measuring the strength and direction of the relationship between two variables, with a coefficient ranging from +1 (perfectly positive) to -1 (perfectly negative). This test does not indicate a causal relationship, but rather the extent to which the two variables are related, and is useful for exploring the relationship between independent and dependent variables in social research.

Table 3. Variable Correlation Analysis

Variable	Fdiit	Ddiit	**Fiscalit**	**Flexibilityit**	Agesit	Islandit	Hdiit
Fdiit	1.0000						
Ddiit	0.4671*** 0.0000	1.0000					
Fiscalit	0.3584*** 0.0000	0.5356*** 0.0000	1.0000				
Flexibilityit	0.0676** 0.0503	0.0027 0.9378	-0.0488 0.1577	1.0000			
Agesit	0.2083*** 0.0000	0.2880*** 0.0000	0.3879*** 0.0000	-0.1579*** 0.0000	1.0000		
Islandit	0.1150 0.0008	0.1574*** 0.0000	0.3717*** 0.0000	-0.0014 0.9673	0.4877*** 0.0000	1.0000	
Hdiit	0.1785*** 0.0000	0.3832*** 0.0000	0.5651*** 0.0000	-0.1894*** 0.0000	0.2970** 0.0000	0.2337*** 0.0000	1.0000

Number of Observations = 840
Explanation of the operationalization of variables in table 1.
*****, **, * = P-value signifikan 1% , 5%, 10%**

Source: Output STATA-17 (2025)

Table 3 shows the correlation analysis between the main variables used in this study. The correlation between FDI_{it} and DDI_{it} is 0.4671, indicating a strong positive relationship between foreign investment and domestic investment. This means that regions that successfully attract a lot of foreign investment tend to also successfully attract domestic investment. The Fiscal variable has a positive relationship with FDI_{it} and DDI_{it} of 0.3584 and 0.5356, respectively, indicating that the more independent a region is, the greater its ability to attract foreign and domestic investment. The $Flexibility_{it}$ correlation between FDI_{it} and DDI_{it} has a positive, albeit weaker, relationship, with FDI_{it} at 0.0676 and DDI_{it} at 0.0027, indicating that increased budget flexibility is not yet strong enough to attract foreign and domestic investment. Each of the control variables $Ages_{it}$, $Island_{it}$, and Hdi_{it} used in this study also shows a significant positive correlation.

Hypothesis Testing: is a crucial component of quantitative research because it determines whether there is an effect, relationship, or difference between the variables being investigated based on empirical evidence. Decisions are made by evaluating the probability value, or p-value, with a significance threshold typically set at $p < 0.05$.

Table 4. Hypothesis Testing Results

$PMA_{it} = \beta 0 + \beta 1 fiscal_{it} + \beta 2 flexibility_{it} + \beta 3 Ages_{it} + \beta 4 Island_{it} + \beta 5 HDI_{it} + e_{it}$ (1)

$PMDN_{it} = \beta 0 + \beta 1 fical_{it} + \beta 2 flexibility_{it} + \beta 3 Ages_{it} + \beta 4 Island_{it} + \beta 5 HDI_{it} + e_{it}$ (2

Variable	**Expected Sign**	**Model 1 FDI**	**Model 2 DDI**
Cons		18.785	4.906
		0.000	0.000
Fiscalit	H1: (+)	0.198***	0.097***
		0.000	0.000
Flexibilityit	H2: (+)	0.962***	0.253***
		0.002	0.018
Agesit	(+/-)	0.040***	0.016***
		0.001	0.000
Islandit	(+/-)	-1.247***	-0.689***
		0.049	0.001
Hdiit	(+/-)	-0.33	0.066***
		0.549	0.001
Prov > F		0.000	0.000
Adj R-Square		0.1429	0.3103
Obs		840	840
Mean vif		1.43	1.43

Explanation of the operationalization of variable in table 1
*****, ** , * = P-value signifikan 1% , 5%, 10%**

Source: Output STATA-17 (2025)

Overall, the results of panel regression testing using the Random Effect Model approach indicate that the Adjusted R-Square value is 0.1429 for the FDI model and 0.3103 for the DDI model. The table above shows that both models are able to explain variations in Foreign Direct Investment (FDI) and Domestic Direct Investment (DDI) of 14.29% and 31.03% on the financial performance of local governments in Indonesia. The Prob value > F of 0.000 indicates that the regression model is significant at the 1% level, making it suitable for explaining the relationship between regional financial performance variables and the level of local government investment. The results of this study also indicate that there are still approximately 54.68% of other variables that are able to explain the financial performance of local governments in Indonesia. In addition, the average VIF of 1.43 indicates that there is no indication of serious multicollinearity, so this model can be said to be valid and suitable for use in explaining variations in regional investment levels.

The control variables, the age of the local government (Ages) shows a positive and significant effect on FDI and DDI, with coefficients of 0.040 and 0.016, respectively, at the 1% significance level. This means that regions that have been established for a longer period of time have more mature institutional systems and experience in fiscal governance. The geographic location variable (Island) shows a significant negative coefficient of -1.247 for FDI and -0.689 for DDI, indicating that regions outside the main growth centers still face challenges in attracting investment. Meanwhile, the Human Development Index (HDI) has a negative effect on FDI of -0.033 but a positive effect on PMDN of 0.066 with a significance level of 10% and 1%, indicating that improving the quality of human resources is a factor that is more considered by local investors than foreign investors.

Regarding the regression results presented in Table 4, the Regional Financial Independence variable shows a positive and significant effect on FDI and DDI, with coefficients of 0.198 and 0.097, respectively, and a significance level at the 1% level. This implies that the more financially independent a region is, as reflected in its ability to finance its own expenditures through Regional Original Income (PAD), the greater the region's potential to attract foreign and domestic investment. Thus, the data used in this study supports H1, that regional financial independence has a positive effect on regional investment levels. The Regional Financial Flexibility variable also has a positive and significant effect on FDI and DDI, with coefficients of 0.962 and 0.253, respectively, with significance levels at the 1% and 5% levels. This indicates that the ability of local governments to adjust their budget structures to dynamic development needs, particularly for investment realization, has a direct impact on increasing incoming investment. Thus, these results are relevant to H2, that regional financial flexibility has a positive effect on regional investment levels.

The first result broadly supports research by Rosidin & Saputra, (2020); Warman & Arza, (2024); and Djamali & Furqan, (2024), which shows that high regional financial independence reflects the ability of local governments to manage fiscal resources independently, thereby providing stable and competitive infrastructure and investment policies, thus encouraging increased domestic investment. Theoretically, increased regional financial independence, in line with the theory of fiscal decentralization, means that regions have the capacity to optimize the management of their fiscal resources, thereby creating fiscal stability and responding to development needs more quickly and appropriately. Thus, fiscally independent regions are able to create a conducive and attractive investment climate for investors, especially long-term investment. (Lubis & Fitriani, 2018); (Utomo & Tambunan, 2024) show that high regional financial independence can indicate good fiscal capacity and regional financial management, thus attracting foreign investment. Regions that are able to finance development independently are considered more stable and have lower fiscal risks, thereby increasing international investor confidence. The findings of this study reinforce the argument that increased fiscal independence strengthens investor confidence in regional financial stability because it demonstrates the ability of local governments to meet their fiscal obligations without heavy dependence on the central government. This creates positive perceptions of fiscal efficiency and sustainability, which are important factors in long-term investment decisions. Furthermore, fiscal independence expands regional fiscal space to finance infrastructure projects, investment incentives, and public services that support productive economic activity.

Therefore, local governments, as policymakers, are expected to continue enhancing financial independence to create a healthy investment environment and support equitable regional development.

The second finding in this study broadly supports previous research showing that fiscal flexibility plays a significant role in driving regional investment levels. (Wu et al., 2024) emphasizes that adaptive fiscal flexibility increases the efficiency and effectiveness of domestic investment realization, thereby creating a conducive and responsive investment climate to economic and development changes. Theoretically, local governments provide flexibility in budget management, allowing regions to adjust spending according to local needs and development dynamics. (Haptari et al., 2022);(Roshdieh & Farzad, 2024) indicate that regions with more flexible fiscal capacity can be more responsive in meeting the basic needs of foreign investors, thus creating a stable and competitive investment climate. Regions with good fiscal flexibility and the ability to manage their finances effectively are able to encourage foreign capital inflows. Fiscal decentralization not only encourages economic growth at the local level but also enlarges the role of local governments in attracting foreign investment by improving public services and increasing the efficiency of budget allocation (Bon, 2019). A study by Arslan-Ayaydin et al., (2014), especially amidst challenging and uncertain fiscal conditions. Budget flexibility allows local governments to shift spending from the consumer sector to productive sectors such as capital expenditure and infrastructure, which directly increases the opportunity for new investment. Furthermore, budget flexibility also serves as a fiscal risk mitigation mechanism, as it allows governments to adjust spending policies when facing economic pressures without compromising regional macroeconomic stability. Findings by Setianto & Kusumaputra, (2017) reinforce this argument by showing that regions with a high level of budget flexibility are able to accelerate development and increase the confidence of domestic and foreign investors through efficient, transparent, and accountable budget management. With adequate financial flexibility, local governments can create a healthy and sustainable investment environment, thereby supporting regional investment levels.

Fiscal independence and financial flexibility have been shown to play a key role in creating a healthy and sustainable investment climate. The combination of these two factors strengthens the synergy between fiscal stability and regional adaptability, which is a crucial prerequisite for attracting both foreign direct investment (FDI) and domestic investment (DDI). However, regional investment decisions are determined not only by fiscal factors but also by external variables such as political stability, infrastructure quality, governance, and human resource quality. These factors have not been included in the model due to limited cross-regional data availability. Therefore, the relationships found in this study reflect general trends rather than a single determinant of regional investment. Future research is recommended to incorporate these variables to obtain a more comprehensive picture of investment determinants at the regional level. The results of this study can provide clear practical implications for regional governments. First, regional governments need to strengthen fiscal capacity by optimizing Regional Original Revenue (PAD) through digitizing the tax and levy system, controlling revenue leakage, and diversifying revenue sources. Second, budget reform policies need to be directed at increasing fiscal flexibility, including by reducing the portion of routine spending and increasing productive capital spending. By strengthening financial independence and flexibility, local governments will not only increase investment attractiveness but also accelerate inclusive and sustainable economic growth across Indonesia.

4. Conclusions

This study empirically demonstrates that regional financial independence and financial flexibility have a positive and significant impact on regional investment levels in Indonesia. The first finding confirms that regional financial independence, reflected in the region's ability to independently manage resources and implement stable fiscal policies, can increase investment attractiveness and strengthen regional economic growth. The second finding indicates that regional financial flexibility, through the ability to adjust budget allocations from consumptive to productive spending, is crucial for accelerating investment realization and supporting sustainable regional development. These results emphasize the importance of strengthening regional fiscal autonomy so that local governments can utilize financial space to provide infrastructure, fiscal incentives, and stable governance to attract investment. Regional governments also need to strengthen fiscal capacity through revenue digitization and spending efficiency to create adaptive and transparent financial management. This study is limited by the scope of variables, which only covers two of the six available financial performance indicators, and by the limited data available through 2022. It is recommended for further research to add other relevant variables such as human resource quality, ease of doing business, risk management index, political stability and infrastructure conditions, and conduct longitudinal analysis with annual data and cross-regional approach among developing countries or comparative studies between regions with different fiscal, demographic and geographical characteristics can enrich the findings and provide insights into the differences in fiscal policy contexts across regions.

References:

Afiah, N. N., Sari, M., & Ihsan, U. (2021). Investasi daerah dan e-government serta implikasinya terhadap kemandirian daerah. *Bina Ekonomi*, 25(2), 115–131.

Amanda, S., & Murwiati, A. (2025). Pengaruh investasi, pengeluaran pemerintah, inflasi dan pendapatan asli daerah terhadap pertumbuhan ekonomi seluruh provinsi di Indonesia tahun 2010–2023. *Economics and Digital Business Review*, 6(2), 13–26.

Arini, P. R., & Kusuma, M. W. (2019). Pengaruh belanja modal dan pendapatan asli daerah terhadap investasi swasta di Indonesia dengan pertumbuhan ekonomi sebagai variabel intervening. *Jurnal Riset Akuntansi dan Manajemen Bisnis (JRAMB)*, 5(1), 28–38.

Arslan-Ayaydin, Ö., Florackis, C., & Ozkan, A. (2014). Financial flexibility, corporate investment and performance: Evidence from financial crises. *Review* *of Quantitative Finance and Accounting*, 42(2), 211–250. http://ssrn.com/abstract=1234682

Balcilar, M., Ciftcioglu, S., & Gungor, H. (2015). The effects of financial development on investment in Turkey. *The Singapore Economic Review*, 61(4), 21. https://doi.org/10.1142/S0217590816500028

Bon, N. Van. (2019). The effect of FDI on the relationship between fiscal decentralisation and economic growth in Vietnam: Empirical evidence from provincial data. *Theoretical Economics Letters*, 9(6), 2093–2109. https://doi.org/10.4236/tel.2019.96132

Deegan, C. (2002). Introduction: The legitimising effect of social and environmental disclosures – a theoretical foundation. *Accounting, Auditing & Accountability Journal*, 15(3), 282–311. https://doi.org/10.1108/09513570210435852

Djamali, S. K. M., & Furqan, A. (2024). The influence of regional head characteristics on regional government investment and level of regional independence (study of provincial governments in Indonesia). *Advances in Economics, Business and Management Research*, 432–449. https://doi.org/10.2991/978-94-6463-400-6_33

Fransisco, F., Firdaus, M., & Mulatsih, S. (2016). Strategi alokasi belanja pemerintah daerah dalam meningkatkan IPM di Provinsi Jambi. *Jurnal Manajemen Pembangunan Daerah*, 8(2), 1–13. https://doi.org/10.29244/jurnal_mpd.v8i2.24816

Freeman, R. E., & McVea, J. (2005). A stakeholder approach to strategic management. *SSRN Electronic Journal*.https://doi.org/10.2139/ssrn.263511

Halawa, L. L., Sukma, M., Limbong, E., & Pangestoeti, W. (2025). Pengaruh kebijakan desentralisasi fiskal terhadap pertumbuhan ekonomi daerah di Indonesia dalam hubungan pemerintah pusat dan daerah terkait keuangan negara. *Studi Administrasi Publik dan Ilmu Komunikasi*, 2(1), 43–53.

Handraini, H., Frinald, A., Asnil, & Putri, E. (2024). Pengaruh pendapatan asli daerah (PAD) dan dana perimbangan terhadap kemandirian keuangan pemerintahan daerah di Kabupaten Pasaman Barat. *Professional: Jurnal Komunikasi dan Administrasi Publik*, 11(2), 593–600.

Haptari, V. D., Soedaryono, B., Sofilda, E., & Siallagan, W. A. (2022). Impact of fiscal decentralization policy on foreign direct investment in Indonesia. *OIDA International Journal of Sustainable Development*, 15(6), 30–44.

Hilirisasi/BKPM, Kementerian Investasi. (2025). Realisasi investasi triwulan III 2025 tembus Rp491,4 triliun: Hilirisasi dan PMDN jadi penggerak utama.

Ika, A. (2009). Analisis pengaruh kinerja keuangan pemerintah kabupaten dan kota terhadap investasi dan produk domestik regional bruto (PDRB) di Jawa Timur. *Jurnal Ilmu Ekonomi dan Manajemen*, 5(4). https://doi.org/10.30996/die.v5i4.85

Kanoli, A. D. S., Syamsul, & Zuhroh, S. (2023). Analisis kondisi keuangan pemerintah daerah Kabupaten Buol tahun 2019–2021. *Jurnal Kolaboratif Sains*, 6(8), 1009–1017. https://doi.org/10.56338/jks.v6i8.3993

Lubis, R. H., & Fitriani. (2018). Pengaruh penanaman modal dalam negeri (PMDN) dan penanaman modal asing (PMA) terhadap perekonomian Sumatera Utara tahun 1987–2016. *Jurnal Ekonomi Pembangunan*, 6(2), 114–131.

Nadzir, M., & Kenda, A. S. (2023). Investasi asing dan investasi dalam negeri: Pengaruhnya pada pertumbuhan ekonomi di Indonesia. *Jurnal Ilmiah Mahasiswa Akuntansi*, 14(1).

Nurliza, W., & Halmawati. (2020). Pengaruh pendapatan asli daerah dan dana perimbangan terhadap belanja modal dan tingkat kemandirian keuangan daerah. *Jurnal Eksplorasi Akuntansi*, 2(1), 2373–2390.

Oates, W. E. (2005). Toward a second-generation theory of fiscal federalism. *International Tax and Public Finance*, 12(4), 349–373. https://doi.org/10.1007/s10797-005-1619-9

Regulation of the Minister of Home Affairs (Permendagri) Number 19 of 2020. (2020). *Regulation of the Minister of Home Affairs of the Republic of Indonesia.*

Roshdieh, N., & Farzad, G. (2024). The effect of fiscal decentralization on foreign direct investment in developing countries: Panel smooth transition regression. *International Research Journal of Economics and Management Studies (IRJEMS)*, 3(7), 133–140. https://doi.org/10.56472/25835238/IRJEMS-V3I7P114

Rosidin, A., & Saputra, A. (2020). Pertumbuhan ekonomi dan penerimaan asli daerah terhadap tingkat kemandirian keuangan daerah. *Gorontalo Development Review*, 3(2).

Setianto, R., & Kusumaputra, A. (2017). Corporate financial flexibility, investment activities, and cash holding: Evidence from Indonesia. *The Indonesian Capital Market Review*, 9(2), 75–85. https://doi.org/10.21002/icmr.v9i2.7470

Suci, S., & Asmara, A. (2014). Pengaruh kemandirian keuangan daerah terhadap pertumbuhan ekonomi kabupaten/kota Provinsi Banten. *Jurnal Ekonomi dan Kebijakan Pembangunan*, 3(1), 8–22. https://doi.org/10.29244/jekp.3.1.8-22

Suryanta, S. (2019). Pengaruh kinerja pengelolaan keuangan daerah terhadap pertumbuhan ekonomi, pengangguran dan kemiskinan di Kota Depok. *Cakrawala Management Business Journal*, 2(2), 372–384. https://doi.org/10.30862/cm-bj.v2i2.45

Syafri, R., Sofilda, E., & Suparyati, A. (2024). Determinan kemandirian keuangan pemerintah kabupaten/kota di Indonesia. *Indonesian Treasury Review: Jurnal Perbendaharaan, Keuangan Negara dan Kebijakan Publik*, 9(4), 277–290.

Utomo, W. I., & Tambunan, M. R. (2024). Pengaruh desentralisasi fiskal, investasi dan tingkat partisipasi angkatan kerja (TPAK) terhadap pertumbuhan ekonomi. *Owner: Riset dan Jurnal Akuntansi*, 8(2), 1968–1984.

Warman, A., & Arza, F. (2024). Pengaruh ukuran pemerintah, pertumbuhan ekonomi dan belanja modal terhadap kemandirian keuangan daerah. *Jurnal Nuansa Karya Akuntansi*, 2(2), 178–188. https://doi.org/10.24036/jnka.v2i2.46

Wu, W., Le, C., Shi, Y., & Alkaraan, F. (2024). The influence of financial flexibility on firm performance: The moderating effects of investment efficiency and investment scale. *Journal of Applied Accounting Research.*https://doi.org/10.1108/JAAR-07-2023-0192

Zulvan, M. F., & Purbasari, H. (2024). Pengaruh investasi, belanja modal, dan pendapatan asli daerah terhadap pertumbuhan ekonomi. *Jurnal Ekonomi dan Manajemen Teknologi (EMT) Kita*, 8(1), 175–186. https://doi.org/10.35870/emt.v8i1.2095