Optimum: Jurnal Ekonomi dan Pembangunan
Vol. 15, No. 2, September 2025, pp. 312-322
DOI:10.12928/optimum.v15i2.14232
ISSN 2613-9464


# Determinants of local government revenue and economic potential: Pathways for revenue enchancement

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ARTICLE INFO

Received : 11-08-2025
Revised : 19-09-2025
Accepted : 22-09-2025
Published : 30-09-2025

**Keywords:**
Fiscal independence
Local government revenue
Economic potential

**JEL Classification:**
H70; H73; R58

ABSTRACT

Fiscal independence represents a critical indicator of regional governments' capacity to finance development without dependence on central government transfers. Klaten Regency continues to exhibit low fiscal autonomy levels with suboptimal of local government revenue (LGR) contributions. This study aims to: a). identify principal factors influencing Klaten Regency's LGR, and b). analyze local economic potential for enhancing revenue sources. The research novelty integrates comprehensive economic factor analysis including Gross Regional Domestic Product (GRDP), population, tourist arrivals, regional taxes, regional levies, and capital expenditure with leading sector identification through Location Quotient (LQ) analysis. This holistic approach fills a significant research gap in Klaten Regency studies. The methodology employs multiple linear regression analysis of six variables, stakeholder interviews, and LQ analysis to determine base economic sectors. Results demonstrate that GRDP, population, and regional taxes have a significant influence on LGR, while tourist numbers, levies, and capital expenditure show no significant impact. Notably, levies exhibit negative effects on revenue generation. The study concludes that LGR enhancement requires optimization of base economic sectors rather than broad-spectrum approaches. Strengthening fiscal capacity demands adaptive, targeted management strategies aligned with local potential. Future research will focus on formulating tourism sector development strategies through regional business management frameworks. This comprehensive analysis provides policymakers with evidence-based insights for improving Klaten's fiscal independence through strategic economic sector development.



## 1. Introduction

Regional financial independence serves as a crucial indicator in assessing a region's capacity to finance its needs without depending on transfers from the central government. Transfer revenue constitutes one source of regional income, but it does not reflect independence in financial management conducted by the government (Rahmawati et al., 2022). Central Statistics Agency of Klaten in 2024 reveals that it still maintains low levels of financial independence, with high dependence on central transfer funds. Figure 1 shows Klaten exhibits high dependence on central transfer funds. Local Government Revenue (LGR) represents all regional income derived from local economic sources managed by regional governments. LGR experiences minor annual fluctuations, but its increase has not been significant in reducing the dominance of central transfer funds. This condition indicates that central government allocations remain the primary source of regional financing. The central government expects autonomous regions to explore new potential and LGR sources to avoid continued dependence on central transfer funds (Ervina & Hidayah, 2024). LGR reflects a region's capability in exploring its economic potential. Various factors can influence OLGR, including local taxes, per capita expenditure, number of MSMEs, tourist visits, GRDP, inflation, population, investment, regional expenditure, local levies, and others (Meidona et al., 2021; Fahrimal et al., 2024).

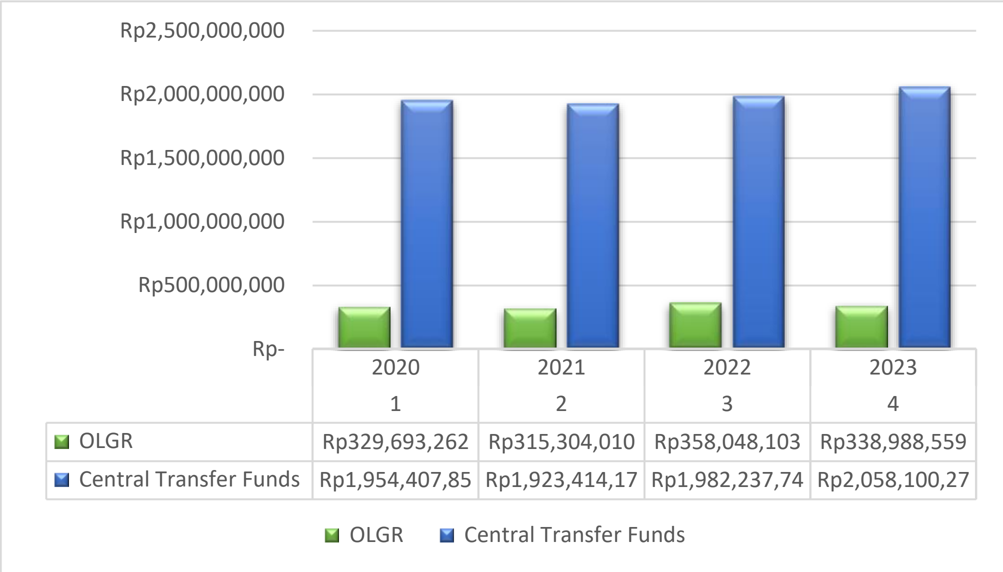


**Figure 1.** Fiscal Dependence of Klaten

Previous research found that the effectiveness of local tax collection contributes significantly to Original Local Government Revenue (Soeksin, 2023). Studies in East Java indicate that per capita income and population positively impact LGR (Sayekti & Wijaya, 2023). Additionally, Special Allocation Funds (SAF) also influence LGR (Satyawati et al., 2023; Basia et al., 2025). Studies found that hotel and restaurant taxes affect LGR (Wahya et al., 2022). In Jakarta, restaurant and advertising taxes can effectively increase LGR, despite their low contribution (Riskarini et al., 2024). Property and Building Tax in Yogyakarta contributes to LGR enhancement (Dari et al., 2022). Research in North Sumatra shows that tourist numbers, GRDP, and workforce influence LGR (Lusiana et al., 2021). The government has endeavored to increase Original Local Government Revenue through local tax optimization policies (Hadiyatno et al., 2020). Several regions have successfully increased LGR by developing leading sectors such as agriculture, forestry, fisheries, trade, and tourism (Valentino & Juwita, 2023; Indriyani et al., 2021; Meilinda & Kurniawan, 2024).

However, many regions still face constraints in developing these sectors due to resource limitations and lack of innovation in exploring local economic potential (Zamzami et al., 2023; Lubis & Fitrianingsih, 2022). Therefore, further analysis of factors influencing regional-level development becomes critically important. Previous studies emphasized the importance of regional revenue diversification and improved financial management (Siregar et al., 2024). Although numerous studies have been conducted across various provinces and major cities in Indonesia, the majority remain general in nature and have not addressed the specific conditions of Klaten Regency. The economic characteristics of Klaten, which are dominated by the agricultural sector, small-scale industries, and tourism, require a different approach compared to metropolitan areas. Therefore, a study focusing specifically on Klaten can fill the gap in the literature while simultaneously providing more relevant recommendations for regional fiscal policy. However, no comprehensive study has yet identified the dominant factors influencing Original Local Government Revenue in Klaten and how local economic potential can serve as a solution for increasing regional revenue.

The research gap related to the study object such as Klaten, there are several other important gaps that need to be identified in studies of factors affecting Local Own-Source Revenue (LGR) and local economic potential. First, many studies remain limited to macroeconomic variables such as Gross Regional Domestic Product (GRDP), population size, and investment, without examining in depth the role of governance, administrative capacity, and innovation in OLGR management (Ginting et al., 2024; Harimurti & Sofyan, 2022; Rukman, 2023; Shofura & Setyadharma, 2023; Wibisono et al., 2024). Second, most studies use simple regression analysis methods and few have applied advanced analytical approaches such as structural equation modeling to reveal more complex causal relationships (Altin et al., 2021; Carolina, 2025; Ginting et al., 2024; Ramadhani et al., 2025). Third, aspects of governance and inter-institutional coordination, as well as the influence of digitalization on LGR optimization, are still rarely explored (Harimurti & Sofyan, 2022; Tahu et al., 2024; Shofura & Setyadharma, 2023). Fourth, research is generally cross-sectional in nature and lacks inter-regional comparisons or longitudinal analysis to observe trends and policy impacts over time (Carolina, 2025; Sukarniati & Lubis, 2021). Finally, the regional financial performance indicators used remain limited, and few studies have comprehensively linked LGR with public service quality and community welfare (Wibisono et al., 2024; Pasandi & Subardin, 2025). Therefore, future research needs to expand the scope of variables, employ more comprehensive analytical methods, and link LGR with regional development outcomes.

The aim of the study is to answer "What factors influence Original Local Government Revenue in Klaten and how can local economic potential contribute to LGR enhancement sources?" This research holds important urgency in helping Klaten improve its fiscal independence to avoid continued dependence on central transfer funds. Furthermore, this research aligns with Indonesia's SDGs, particularly goal 8 (inclusive economic growth) and Indonesia's Asta Cita 6 by identifying factors influencing Original Local Government Revenue to optimize local economic potential, thereby enhancing regional fiscal independence, promoting village-based economic growth, creating welfare equity, and contributing to poverty alleviation efforts in Klaten. The study highlights an innovative approach in optimizing Original Local Government Revenue by emphasizing the utilization of local economic potential as the primary source of fiscal independence enhancement. Unlike previous research that generally discussed factors influencing LGR such as population, GRDP, investment, inflation, local taxes, local levies, capital expenditure, and tourist visits (Puri & Restikasari, 2025; Ul Albab et al., 2020; A'yun et al., 2022). This research focuses not only on identifying factors influencing LGR but also on identifying leading sectors with potential to increase Klaten's LGR. The research gap is clearly evident from the scarcity of studies that specifically examine LGR in Klaten Regency, particularly studies that link the determinant factors of LGR with regional economic potential based on leading sectors. Most previous research has focused on other regions with different contexts, thus failing to meet the empirical needs of Klaten Regency.

The novelty of this research lies in two aspects. First, this research not only examines factors generally influencing LGR but also identifies Klaten's economic potential. Second, no research has specifically addressed LGR factors and leading sectors in Klaten, as previous studies were predominantly conducted in other regions. Therefore, findings from this research can provide new contributions to regional fiscal policy in enhancing Klaten's financial independence. The problem-solving approach in this research focuses on identifying key factors influencing Klaten's Original Local Government Revenue and leading sectors with potential to increase LGR. The problem-solving strategy involves identifying factors influencing Klaten's LGR and exploring local economic potential that can be developed as LGR enhancement sources. This research remains highly relevant for investigation, considering that the current fiscal independence of Klaten Regency is still classified as low. Dependence on transfer funds from the central government also remains high, despite the implementation of various fiscal policies. This indicates a gap between the existing local economic potential and its contribution to Regional Original Revenue. The urgency of this research lies in the need for regional governments to design effective strategies for managing local economic potential, thereby enabling sustainable enhancement of Original Local Government Revenue (LGR). The research objectives are: (1) to identify factors influencing LGR in Klaten Regency, and (2) to analyze local economic potential that contributes to LGR enhancement.

## 2. Literature Review

Original Local Government Revenue (LGR - *Pendapatan Asli Daerah*) is a crucial indicator for assessing fiscal independence and sustainable development of a region. Numerous studies demonstrate that LGR enhancement is significantly influenced by how effectively governments can manage local economic potential. Altin et al (2021) emphasizes that although economic growth (PDRB) provides opportunities to enhance OLGR, without proper governance, its impact may not be significant. The same point is also affirmed by William & Harjanto (2024) and Salim et al (2024) highlights the importance of developing leading sectors such as trade and tourism, so that their contribution to LGR can be truly felt. Additionally, demographic factors and community activities also play a very important role. Kurniawan & Anggraini (2024) found that population growth can influence fiscal capacity by increasing regional expenditure needs. However, the contribution to OLGR remains highly dependent on purchasing power and community participation in paying taxes and levies.

The tourism sector has indeed become one of the most promising areas. Siddiqa (2023) found that an increase in the number of tourists directly influences the enhancement of Regional Original Revenue (LGR), both through tourism object levies and positive impacts on transportation, accommodation, and local consumption sectors. This finding aligns with international research by He & Wang (2022) confirmed that tourism can serve as a driver of economic growth and regional sustainability. From the fiscal instrument perspective, regional taxes have proven to be the dominant contributor to LGR across various regions Satyawati et al (2023) and Sukartiningsih (2022). Conversely, regional levies generally provide smaller contributions, although they have potential if managed professionally (Jabid et al., 2023). Capital expenditure is also considered important as an indirect factor that strengthens OLGR capacity through infrastructure development and enhancement of regional assets (Pramesti & Budi, 2025; Utomo et al., 2021). The literature demonstrates that LGR enhancement depends not only on economic growth, population size, or the tourism sector alone, but most importantly on how regional governments can manage existing potential, maximize tax and levy revenues, and allocate capital expenditure appropriately.

Furthermore, several significant gaps warrant identification in studies examining factors that influence Local Own-Source Revenue (LGR) and regional economic potential. First, numerous research efforts remain constrained to macroeconomic variables such as Gross Regional Domestic Product (GRDP), population size, and investment levels, without thoroughly examining the roles of governance, administrative capacity, and innovation in LGR management (Altin et al., 2021; Carolina, 2025; Ginting et al., 2024; Harimurti & Sofyan, 2022; Ramadhani et al., 2025). Second, the majority of studies employ basic regression analysis methods and have yet to extensively apply advanced analytical approaches such as structural equation modeling to reveal more complex causal relationships (Rukman, 2023; Shofura & Setyadharma, 2023; Wibisono et al., 2024). Third, governance aspects and inter-institutional coordination, along with digitalization's impact on LGR optimization, remain rarely explored. Fourth, research typically adopts cross-sectional designs and lacks comparative analysis across regions or longitudinal examination to observe trends and policy impacts over time (Carolina, 2025; Ramadhani et al., 2025). Finally, regional financial performance indicators utilized remain limited, with few studies comprehensively linking OLGR to public service quality and community welfare (Ginting et al., 2024; Harimurti & Sofyan, 2022; Hayat et al., 2023). Consequently, future research should broaden variable coverage, employ more comprehensive analytical methods, and establish connections between LGR and regional development outcomes.

## 3. Method

This study used a quantitative approach using secondary data. Secondary data was sourced from Klaten regional financial reports and Statistics Indonesia's Klaten data from 2015-2024. This research uses a sample encompassing matters related to Klaten's LGR. The research sample consists of regional government financial data and Statistics Indonesia data. This study conduct three data analyses: descriptive data analysis, quantitative data analysis, and Klaten leading sector analysis. Descriptive analysis is used to describe trends in LGR development in Klaten and factors influencing it generally. Quantitative analysis is used to test the magnitude and significance of variable X influence on LGR using multiple regression. The equation for regression based on Fahriza et al (2022) as follows:

$$LGR = \alpha_0 + \beta_1 GRDP + \beta_2 POP + \beta_3 NT + \beta_4 RT + \beta_5 RR + \beta_6 CE + \varepsilon \quad (1)$$

Where $LGR$ is the original local own-source revenue from Klaten; $GRDP$ is the gross regional domestic product; $POP$ is the total population; $NT$ is number tourist visits to Klaten regency; $RT$ is the total accumulation for regional tax; $RR$ is the regional retribution; $CE$ is the capital expenditure; $\alpha_0$ is the constanta; $\beta_1 - \beta_6$ is the coefficient of independent variables; $\varepsilon$ is the disturbance error. All the data obtained from Central Statistics of Klaten Regency (Badan Pusat Statistik Kabupaten Klaten) and Regional Financial Report. Location Quotient (LQ) analysis is used to determine Klaten's leading economic sectors. LQ assists local governments in identifying sectors with potential for development to drive local economic growth (Pasandi & Subardin, 2025) and the leading sector can be an economic driver because it generates a surplus for export (Jakimowicz & Rzeczkowski, 2021). The LQ calculation for Klaten is as follows:

$$LQ = \frac{\left(\frac{GRDP\ sector\ in\ Klaten\ Regency}{Total\ GRDP\ of\ Klaten}\right)}{\left(\frac{GRDP\ sector\ in\ Central\ Java}{Total\ GRDP\ of\ Central\ Java}\right)} \quad (2)$$

Where LQ > 1 → the region has specialization or locational advantage in that sector → can be considered a base sector that serves a market broader than its own region; LQ = 1 → the sector is proportional to the national average → no particular advantage and LQ < 1 → the sector is less developed than the national average.

## 4. Results and Discussion

Figure 2 shows the development of Klaten's OLGR and its influencing factors between 2015 and 2024. Overall, OLGR shows significant progress, increasing from approximately Rp 190 billion to Rp 372 billion, reflecting positive dynamics in regional fiscal capacity. Gross Regional Domestic Product (GRDP) as an indicator of regional economic growth also experienced substantial increases, from Rp 29 trillion to over Rp 55 trillion, indicating this region's economic development. Stable population provides potential for broader revenue base. Additionally, tourist numbers surged dramatically, especially since 2021, reaching over 6.8 million in 2024, with great potential to increase OLGR through the tourism sector. Local tax revenue continues increasing annually, becoming one of OLGR's main sources. Meanwhile, local levies remained relatively stable before finally surging in 2024, showing optimization potential. Capital expenditure initially declined but began recovering toward the end of the period, potentially driving future economic growth.

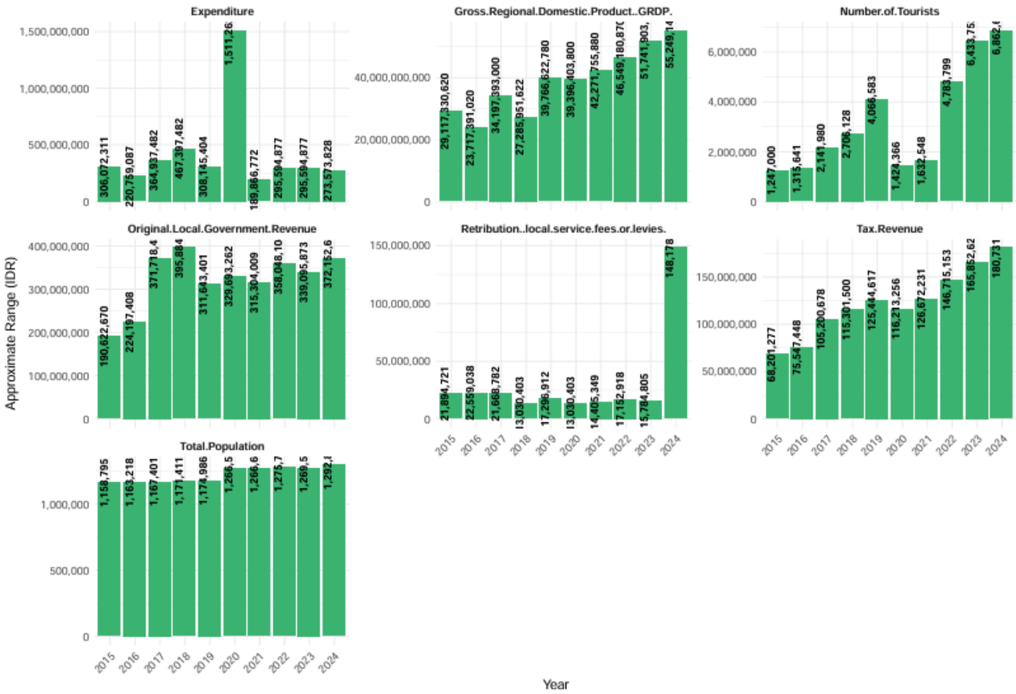


**Figure 2**. Visualization for Each Variables in Klaten Regency

The regression approach used in the study to identify the main factors affecting OLGR improvement and serves as a basis for regional fiscal policy decisions. To ensure the regression model was valid, several classical assumption tests were performed. The autocorrelation test (Durbin–Watson) confirmed that the residuals were independent ($p = 0.7879$), while Bartlett's test for homoscedasticity showed that the residuals had constant variance ($p = 0.1594$). The normality test indicated that the residuals followed a normal distribution ($p = 0.9336$). Variance Inflation Factor (VIF) values showed multicollinearity only for variable $X_1$ (VIF < 10), whereas the other variables were acceptable. An ANOVA test then confirmed that, overall, the six independent variables significantly affected OLGR ($p = 0.02$). Table 1 shows that Gross Regional Domestic Product (GRDP) has significant positive effect on local government revenue with coefficient of 0.004, t-value 2.584, and significance 0.040. This finding aligns with research conducted by William & Harjanto (2024) and A'yun et al (2022) states the more active a region's economy, the greater the opportunity to increase local government revenue. This result also strengthens the view that optimizing regional economic potential is key to increasing regional revenue. This result strengthen that GRDP growth indicates increased production and consumption activities, expanding the tax base led to LGR enhancement.

**Table 1**. Result of Multiple Regression

| Variables | Coefficient |
|---|---|
| GRDP | 0.004<br>(2.584)** |
| POP | 1.909<br>(3.487)** |
| NT | 0.007<br>(1.262) |
| RT | 1.284<br>(2.737)** |
| RR | -15.976<br>(-4.418)*** |
| CE | 249.074<br>(1.442) |
| C | 268.719<br>(1.852) |
| Diagnostic Tools | |
| Normality Test | 0.9336 |
| Autocorrelation | 0.7879 |
| Heteroskedasticity | 0.1594 |
| Multicolinearity | < 10 for each independent variables |

Source: data processed

Population has positive and significant impact on LGR with coefficient of 1.909 and t-stat 3.487, and significance 0.040. Population can be both potential and challenge. It can be potential because larger populations expand tax base and increase local consumption. However, when not accompanied by income increases, it becomes a challenge and fiscal burden. Therefore, sectoral fiscal policies through incentives and disincentives directing toward potential sector contributions are needed. Meanwhile, tourist numbers have positive insignificant to LGR. This finding indicates the tourism sector in Klaten has not been able to provide real contribution to LGR. Based on data from tourism office, showing a decline in the number of tourists over the past 5 years and tourism sector has not been able to contribute significantly to LGR. This is caused by tourism object management mostly conducted by villages/communities, lack of supporting facilities like toilets and road access, and absence of orderly levy systems. One informant mentioned that although accommodation and food and beverage are base sectors, integration between tourism destinations and digitalization utilization remain not optimal to spurs of LGR in Klaten regency.

Local taxes has significant effect on LGR in Klaten regency and the coefficient of 1.284 means increases in regional taxes will increase the LGR. This finding aligns with research conducted by Satyawati et al (2023) and Sukartiningsih (2022) states that taxes are the main source of LGR revenue and directly contribute to regional revenue increases. This result is reinforced with the Head of Klaten's original local government revenue Division, revealing that the largest Original Local Government Revenue still relies on the tax sector. Table 1 shows the retribution has negative impact on LGR in Klaten. The finding indicates problems in levy management, making their contribution to LGR ineffective and in line with the previous studies from Hadiyatno et al (2020) and Ul Albab et al (2020) reveals that levy contributions to LGR tend to be small and have not reached optimal potential. Klaten regency face serious challenges on regional retributions from high collection costs, limited human resources, digitalization, and management scattered across various Regional Government Organizations (RGO) cause low contributions and even negative impacts.

Capital expenditure insignificant to LGR in Klaten regency. The finding indicates capital expenditure effectiveness depends on which sectors are developed. If capital expenditure is not directed toward building productive sectors, results will not be significant. Capital expenditure should be directed toward productive sectors like MSMEs, industry, and tourism. If capital expenditure only focuses on infrastructure without strengthening leading sectors, its effect on LGR not optimal. Table 2 shows average LQ analysis from 2015 to 2024, several sectors stand out as base sectors. Base sectors include electricity and gas supply (LQ=1.60), education services (LQ=1.65), health and social activities (LQ=1.21), mining and quarrying (LQ=1.21), financial and insurance activities (LQ=1.22), accommodation and food service activities (LQ=1.17), manufacturing industry (LQ=1.01), and other services (LQ=1.02). these sectors play important roles in regional economy. conversely, several sectors are still considered non-base, such as agriculture (LQ=0.83), transportation and storage (LQ=0.69), water supply and waste management (LQ=0.72), construction (LQ=0.57), real estate (LQ=0.78), professional services (LQ=0.87), and public administration (LQ=0.90).

**Table 2**. Result of LQ Analysis

| Sector | Average LQ (2015-2024) | Result |
|---|---|---|
| Agriculture, Forestry, Fisheries | 0.83 | Non-Base |
| Mining and Quarrying | 1.21 | Base |
| Manufacturing Industry | 1.01 | Base |
| Electricity and Gas Supply | 1.60 | Base |
| Water Supply; Waste Management, Sewerage and Recycling | 0.72 | Non-Base |
| Construction | 0.57 | Non-Base |
| Wholesale and Retail Trade; Motor Vehicle and Motorcycle Repair | 1.20 | Base |
| Transportation and Storage | 0.69 | Non-Base |
| Accommodation and Food Service Activities | 1.17 | Base |
| Information and Communication | 0.89 | Non-Base |
| Financial and Insurance Activities | 1.22 | Base |
| Real Estate | 0.78 | Non-Base |
| Professional Services | 0.87 | Non-Base |
| Public Administration, Defense and Social Security | 0.90 | Non-Base |
| Education Services | 1.65 | Base |
| Health and Social Work Activities | 1.21 | Base |
| Other Services | 1.02 | Base |

Source: data processed

Table 1 shows GRDP has positive and significant affect on LGR. This aligns with base sector conditions dominated by service, processing, and energy sectors, which directly contribute to regional economic growth. The more developed base sectors become, the higher the potential for regional revenue through taxes and levies. Additionally, population has significant impact on Original Local Government Revenue (LGR). This is highly relevant to service sectors like education, health, and other services serving as foundations. The larger the population, the greater the need for such services, which in turn increases economic circulation in service sectors. However, it is interesting to note that the tourism sector, including accommodation and food, is also considered a base sector (LQ=1.17). Nevertheless, in regression analysis, tourist numbers do not significantly affect LGR. Meanwhile, local levies show significant negative impact on LGR. This could occur because non-base sectors like water management, construction, and transportation, which often become levy objects, are not developing well. Consequently, generated levies become unproductive or even burdensome. Interview findings reveal that several base sectors like electricity and gas supply, financial services, and other services have not been fully utilized by regional governments to increase LGR. This is because most of these sectors are managed by private sector or central government, so contributions to regional treasury are limited to indirect taxes.

## 5. Conclusion

This study analyze the factors affect on original local government revenue (LGR) in Klaten regency and identified local economic potential as sources for revenue enhancement through multiple linear regression analysis, stakeholder interviews, and Location Quotient (LQ) analysis. The quantitative findings revealed that Gross Regional Domestic Product (GRDP), population size, and regional taxes have positive and significant effects on LGR, supporting the fundamental relationship between economic growth, demographic factors, and tax collection efficiency in driving regional fiscal capacity. Conversely, tourist numbers, regional levies, and capital expenditure showed no significant impact on LGR, with regional levies demonstrating a particularly concerning negative effect that indicates serious management inefficiencies and institutional challenges in levy collection systems.

The Location Quotient analysis identified nine base sectors with competitive advantages, including electricity and gas supply (LQ=1.60), education services (LQ=1.65), health and social activities (LQ=1.21), manufacturing industry (LQ=1.01), accommodation and food service activities (LQ=1.17), and financial services (LQ=1.22), representing significant untapped potential for LGR enhancement. However, the disconnect between tourism sector potential (identified as a base sector) and its insignificant contribution to LGR highlights critical gaps in sector-specific policies and management strategies. These findings demonstrate that LGR enhancement requires targeted optimization of base economic sectors rather than broad-spectrum approaches, necessitating institutional reform in levy collection systems, digitalization of tax and levy mechanisms, strategic partnerships with private sector entities, multi-stakeholder collaboration for tourism development, and capacity building in fiscal governance.

This research provides the first comprehensive analysis of LGR factors specific to Klaten Regency, filling a significant gap in regional fiscal literature through its novel integration of quantitative factor analysis with leading sector identification. The study establishes that Klaten's path to fiscal independence lies not in expanding revenue sources broadly, but in strategically optimizing existing base sectors while strengthening institutional capacity for effective fiscal governance. Future research should focus on formulating tourism sector development strategies based on regional business management approaches, addressing institutional challenges in levy management, and developing time-series analysis to better understand dynamic relationships between economic factors and regional revenue generation over time.

## Acknowledgment

Authors express gratitude to the Ministry of Education, Culture, Research and Technology through the Directorate of Research and Community Service (DPPM) for funding support in 2025, enabling this research to be conducted successfully.

## Declarations

| | | |
|---|---|---|
| **Author contribution** | : | All authors contributed well to completing this article. |
| **Funding statement** | : | No funding statement for this paper. |
| **Conflict of interest** | : | The authors declare no conflict of interest. |
| **Additional information** | : | No additional information is available for this paper. |

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