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The Relationship of Inflation and Economic Growth to the Financial Performance of the Makassar City Government

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Abstract

Financial performance serves as a key indicator of local government accountability, reflecting the efficiency of revenue collection and regional expenditure management. Understanding how macroeconomic factors such as inflation and economic growth influence financial performance is crucial for effective fiscal policy and sustainable development. This study examines the relationship between inflation and economic growth on the financial performance of the Makassar City Government from 2015 to 2024. Using a quantitative research design, secondary time series data were collected and analyzed through the Spearman rank correlation method. The results indicate that inflation has a positive but weak correlation with financial performance ($r = 0.224$, $p > 0.05$), while economic growth exhibits a very weak relationship ($r = 0.103$, $p > 0.05$). These findings suggest that macroeconomic fluctuations have limited impact on regional fiscal performance, largely due to the city's dependence on central government transfers and fixed expenditure structures. The study highlights the need to incorporate additional socio-economic variables, such as regional investment, unemployment rates, poverty levels, and the Human Development Index (HDI), to better explain variations in financial performance. Future research is recommended to employ more advanced analytical methods, including multiple regression, Vector Autoregression (VAR), or SEM-PLS, to capture the complex interactions between macroeconomic indicators and local government financial management. The insights from this study provide practical guidance for policymakers to enhance fiscal efficiency, optimize regional revenues, and support sustainable economic growth.

1. Introduction

Decentralization in Indonesia has significantly altered the governance structure, providing local governments with broader authority to manage their regions independently. Law No. 23 of 2014 concerning Regional Government and Law No. 33 of 2004 regarding the Financial Balance between the Central and Regional Governments grant district- and city-level governments the authority to carry out comprehensive governmental functions, including planning, budgeting, control, and evaluation. This legal framework encourages local governments to fully utilize their potential in regional development, thereby promoting fiscal independence and reducing dependency on central government transfers (Lucky, 2013).

Effective regional financial management is a critical mechanism for achieving accountability, transparency, and efficiency in local government operations. It is reflected through the regional revenue and expenditure budgets (APBD), which serve as instruments for regulating development activities and ensuring responsible financial management. Regional financial performance is a key metric for assessing the success of local governments in utilizing their fiscal resources. Financial performance encompasses various aspects of local revenue mobilization, expenditure management, and budgetary efficiency, which collectively indicate the government's capability to deliver public services while maintaining fiscal stability (Lathifa & Haryanto, 2023).

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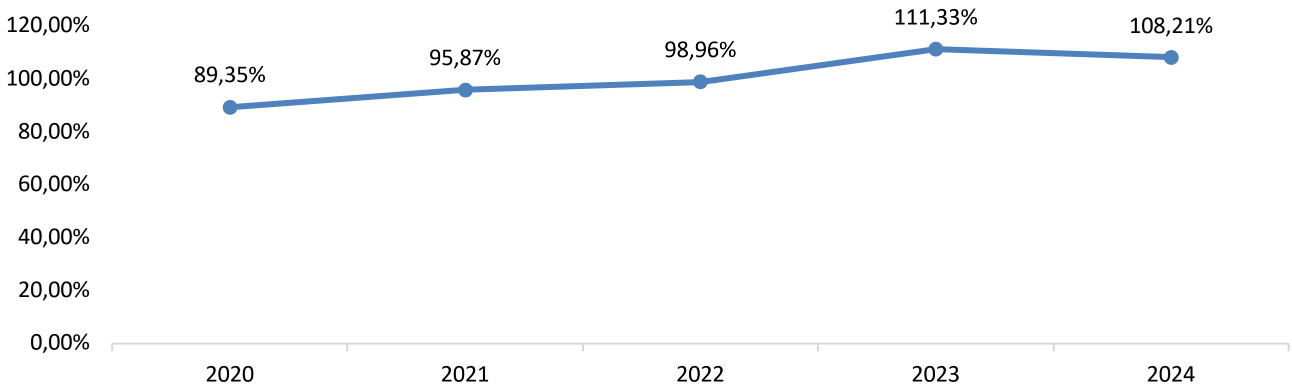
Figure 1.1: Financial Performance of Makassar City (2020–2024)



Source: Directorate General of Taxes, 2023; Data Processed

Analysis of data from the Directorate General of Financial Balance indicates fluctuations in Makassar City's financial performance over the 2020–2024 period. In 2020, the ratio of realized expenditure to regional revenue was 89.35%, marking a significant decline from the previous year. This decrease was closely associated with the economic impact of the COVID-19 pandemic, which resulted in slowed economic activity and reduced local revenue. Subsequently, in 2021 and 2022, financial performance gradually recovered to 95.87% and 98.96%, respectively, reflecting the stabilization of regional fiscal conditions and the resurgence of economic activities.

The financial performance peaked in 2023, with a ratio of 111.33%, indicating that regional expenditures exceeded revenues. This situation could reflect the implementation of expansionary fiscal policies or increased public spending to stimulate economic recovery. In 2024, the ratio slightly decreased to 108.21%, yet it remained above the ideal benchmark, highlighting the continuous need for careful budgetary control and revenue optimization to ensure sustainable fiscal health. These trends underscore the importance of understanding the factors influencing financial performance, particularly macroeconomic variables such as inflation and economic growth.

Inflation is widely recognized as a crucial indicator of regional economic stability. Defined as a general and sustained increase in the price of goods and services over a period, inflation can directly impact government financial performance by affecting purchasing power, operational costs, and public service delivery (Sukirno, 2022). High inflation can increase the cost of public expenditure, reduce the real value of revenues, and create inefficiencies in regional financial management. Conversely, economic growth, as an indicator of the expansion of regional production and service capacity, can positively influence financial performance by increasing tax revenues, local levies, and investment potential (Rahajaan, 2023).

Makassar City, as the capital of South Sulawesi Province, has experienced rapid economic growth in recent years. However, despite favorable macroeconomic conditions, the direct influence of economic growth and inflation on financial performance remains complex. The city’s fiscal structure is characterized by substantial reliance on central government transfers, such as the General Allocation Fund (DAU) and the Special Allocation Fund (DAK). For instance, in 2023, the city received IDR 1.47 trillion from DAU and IDR 284 billion from DAK. This reliance provides budgetary stability but may limit the observable impact of inflation or local economic

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growth on fiscal efficiency. In addition, the fixed composition of most expenditures constrains fiscal flexibility, further weakening the direct relationship between macroeconomic indicators and financial performance outcomes.

The relationship between inflation, economic growth, and local government financial performance is also theoretically grounded in Public Finance Theory as proposed by Musgrave (1959). This theory emphasizes three primary functions of government: allocation, distribution, and stabilization. The allocation function ensures efficient resource distribution for public goods and services, the distribution function promotes equitable income allocation to reduce social disparities, and the stabilization function focuses on maintaining economic stability, including price stability and sustainable fiscal management. At the regional level, these functions are critical for evaluating the efficiency of local governments in mobilizing and utilizing financial resources to achieve developmental objectives.

From a Keynesian perspective, the stabilization function is particularly important, as uncontrolled inflation can erode purchasing power, increase government operational costs, and reduce efficiency in public spending. Price stability is therefore essential for optimizing the effectiveness of government expenditures and ensuring that fiscal resources contribute meaningfully to regional development. Local governments must balance macroeconomic pressures with the need for efficient financial management, highlighting the importance of understanding how inflation and economic growth affect financial performance.

Despite the theoretical basis, empirical studies present mixed results. Some research indicates a significant positive relationship between macroeconomic variables and local government performance, while others report weak or non-significant effects (Aqilah et al., 2023; Sinaga, 2021; Aminin, 2024). These inconsistencies suggest that the influence of inflation and economic growth on regional financial performance is context-dependent, shaped by factors such as fiscal dependency, expenditure rigidity, and administrative efficiency.

Research Gap and Contribution Most existing studies on regional financial performance are cross-sectional or limited to specific regions, often neglecting the longitudinal analysis of macroeconomic impacts over an extended period. This study addresses this gap by analyzing the relationship between inflation, economic growth, and financial performance in Makassar City over a ten-year period (2015–2024). By integrating both macroeconomic indicators and fiscal performance metrics, this study provides a comprehensive understanding of how external economic conditions interact with local fiscal management. The findings aim to inform evidence-based policy recommendations for enhancing financial efficiency, promoting fiscal sustainability, and supporting long-term regional development.

Research Objectives

This study aims to examine the relationship between inflation and economic growth and the financial performance of the Makassar City Government. The specific objectives include:

1. Analyzing trends in financial performance between 2015 and 2024.
2. Assessing the correlation between inflation rates and financial efficiency.
3. Evaluating the influence of economic growth on fiscal performance.
4. Providing policy recommendations for improving local financial management and supporting sustainable development.

By achieving these objectives, the study contributes both to academic literature on public finance and practical governance by offering insights for policymakers and financial administrators in enhancing regional fiscal efficiency.

Significance of the Study

This research is significant in several ways. First, it provides a long-term,

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comprehensive assessment of financial performance in a major Indonesian city, offering insights into trends, challenges, and opportunities. Second, by integrating macroeconomic indicators with fiscal data, the study contributes to understanding how inflation and economic growth affect local government efficiency. Third, the findings offer actionable guidance for policymakers to optimize revenue mobilization, control expenditures, and ensure sustainable fiscal management. Finally, the study enhances the theoretical and practical understanding of public finance at the regional level, providing a basis for future research in Indonesia and similar decentralized contexts.

In conclusion, understanding the dynamic interplay between inflation, economic growth, and financial performance is essential for promoting efficient, accountable, and sustainable fiscal management at the regional level. This study provides a decade-long analysis of these relationships in Makassar City, aiming to bridge the gap between theory and practice, offer empirical insights, and inform effective policy interventions. By combining theoretical frameworks with longitudinal empirical data, the research seeks to contribute to both academic scholarship and practical governance improvements in Indonesia.

2. Literature Review

2.1 Public Finance Theory

Public finance theory explains the role of government in managing public resources to achieve economic efficiency, equity, and macroeconomic stability. Musgrave (1959) introduced three core functions of public finance: allocation, distribution, and stabilization. The allocation function focuses on the efficient provision of public goods and services, the distribution function aims to reduce income inequality, and the stabilization function seeks to maintain economic stability through fiscal policy. In the context of regional governments, these functions are reflected in budget allocation decisions, revenue management, and expenditure control, which directly influence fiscal performance and regional economic outcomes.

2.2 Local Government Financial Performance

Local government financial performance refers to the ability of regional governments to manage revenues and expenditures efficiently, effectively, and sustainably in accordance with legal and administrative regulations. Financial performance is commonly measured using fiscal ratios such as independence, effectiveness, efficiency, activity, and growth ratios (Pratiwi, 2018). Among these indicators, the efficiency ratio is frequently used to evaluate how well regional governments convert financial resources into public services. A lower efficiency ratio indicates better financial performance, as it reflects lower costs incurred relative to revenue realization. Efficient financial management is essential for improving service delivery and supporting regional economic development.

2.3 Inflation

Inflation is defined as a sustained increase in the general price level of goods and services over time (Sukirno, 2022). In Indonesia, inflation targeting is regulated under Law No. 23 of 1999 concerning Bank Indonesia. Inflation has important fiscal implications, particularly for regional governments, as rising prices can increase public expenditure while reducing real revenue capacity. High inflation may weaken purchasing power, distort budget planning, and reduce the effectiveness of public spending, thereby affecting local government financial performance and economic stability.

2.4 Economic Growth

Economic growth refers to the long-term increase in a region’s capacity to produce goods and services, commonly measured by Gross Regional Domestic Product (GRDP). According to Sukirno (2022), economic growth results from improvements in production factors, technology, and institutional quality. Efficient public financial management plays a crucial role in supporting economic growth by ensuring optimal allocation of public funds, promoting infrastructure development, and enhancing public service quality. Conversely, weak fiscal efficiency may hinder growth by limiting productive government investment.

2.5 Relationship between Financial Performance, Inflation, and Economic Growth

The interaction between local government financial performance, inflation, and economic growth can be explained through public finance theory. Efficient fiscal management enhances the allocation and stabilization functions of government, enabling regions to mitigate inflationary pressures and stimulate economic growth. Empirical studies suggest that improved fiscal efficiency contributes to better macroeconomic outcomes by increasing investor confidence, improving public service delivery, and strengthening regional economic resilience. Therefore, understanding the role of financial efficiency in managing inflation and promoting economic growth is essential for evaluating regional fiscal performance.

3. Research methods

3.1 Research Design

This study adopts a quantitative descriptive research design to examine the relationship between inflation, economic growth, and local government financial performance. A correlational approach is employed to identify the direction and strength of associations among variables without inferring causality.

3.2 Study Area and Period

The research is conducted in Makassar City, Indonesia, covering a ten-year period from 2015 to 2024. This period was selected to capture medium-term economic dynamics and fiscal performance trends under varying macroeconomic conditions.

3.3 Data Type and Sources

The study utilizes secondary quantitative data obtained from official and publicly accessible sources. Inflation and economic growth data are sourced from the Makassar City Central Statistics Agency (BPS), while local government financial performance data are obtained from the Makassar City Government's financial statements and the Directorate General of Fiscal Balance (DJPK), Ministry of Finance.

3.4 Population and Sample

The population comprises all annual records of inflation, economic growth, and regional financial performance of Makassar City from 2015 to 2024. The sample consists of ten annual observations for each variable, including the annual inflation rate, economic growth measured by Gross Regional Domestic Product (GRDP) at constant prices, and financial performance indicators.

3.5 Variable Measurement

- **Inflation (INF)** is measured as the annual percentage change in the general price level in Makassar City.
- **Economic Growth (EG)** is measured by the annual percentage growth of GRDP at constant prices.
- **Local Government Financial Performance (FP)** is measured using the efficiency ratio, calculated as the ratio of realized regional revenue to realized regional expenditure, multiplied by 100 percent. A lower ratio indicates higher financial efficiency.

3.6 Data Analysis Technique

Data analysis is conducted using non-parametric statistical methods. Spearman's rank correlation coefficient is applied to examine the relationship between inflation, economic growth, and financial performance, considering the limited sample size and potential non-normal data distribution. The strength of correlations is interpreted based on established coefficient thresholds, and statistical significance is evaluated at a 5 percent significance level (α = 0.05).

3.7 Ethical Considerations

All data used in this study are secondary data obtained from official government publications, ensuring transparency, reliability, and ethical compliance in data usage.

4. Results and Discussion

4.1 Overview of Empirical Results

This section presents and discusses the empirical findings of the study on the relationship between inflation, economic growth, and the financial performance of the Makassar City Government over the period 2015–2024. The analysis is divided into descriptive statistics and correlation analysis, followed by an in-depth discussion that integrates empirical results with relevant public finance theories and previous empirical studies.

4.2 Descriptive Analysis

Figure 4.1

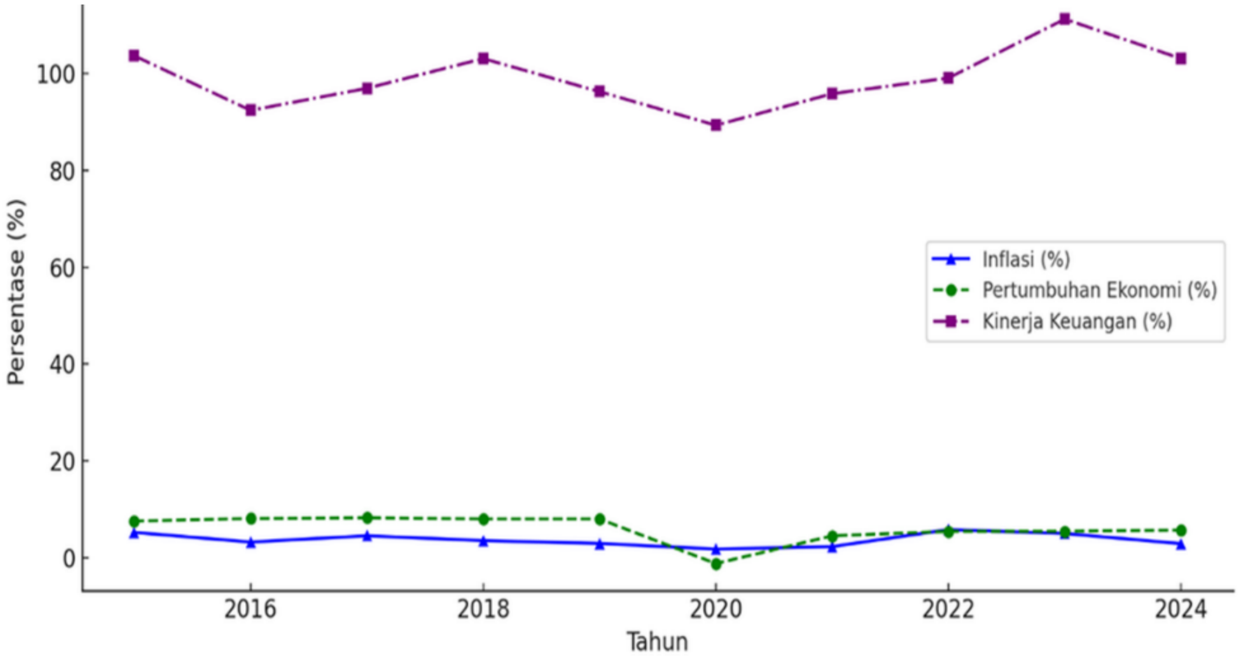

Figure 4.1. Trends in Inflation, Economic Growth, and Financial Performance of the Makassar City Government (2015–2024)
Note: The figure illustrates annual movements in inflation rates, economic growth, and the efficiency-based financial performance ratio of the Makassar City Government during the study period.

Figure 4.1 illustrates the dynamic trends of inflation, economic growth, and local government financial performance in Makassar City over a ten-year period. Overall, the figure shows that the three variables do not move consistently in the same direction, indicating potential structural and institutional factors influencing fiscal performance beyond macroeconomic conditions.

The most notable fluctuation occurred in 2020, when economic growth contracted sharply to −1.27 percent, coinciding with the lowest recorded financial performance level of 89.35 percent. This decline reflects the economic shock caused by the COVID-19 pandemic, which significantly affected regional economic activity and fiscal management capacity. In contrast, inflation reached its lowest level in 2024 at 1.19 percent, yet this reduction was not accompanied by an improvement in financial performance, suggesting a weak linkage between price stability and fiscal efficiency.

Table 4.1

Variable	N	Minimum	Maximum	Average	Std. Deviation
CD	10	89.35	111.33	99.6500	6.86861
INF_1	10	1.19	5.18	3.2310	1.33157
PE_2	10	-1.27	8.79	6.0460	3.00382
Valid	10				

Table 4.1. Descriptive Statistics of Research Variables (2015–2024)

Note: Financial performance is measured using the efficiency ratio (%), inflation is measured as the annual inflation rate (%), and economic growth is measured by GRDP growth at constant prices (%).

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Financial Performance (KK)	10	89.35	111.33	99.65	6.87
Inflation (INF)	10	1.19	5.18	3.23	1.33
Economic Growth (EG)	10	-1.27	8.79	6.05	3.00

The descriptive statistics indicate that the average financial performance of the Makassar City Government during the study period was 99.65 percent, suggesting that, on average, regional financial management operated close to an efficient level. However, the relatively wide range between the minimum and maximum values indicates fluctuations in fiscal efficiency across years. Inflation remained relatively moderate, with an average rate of 3.23 percent, reflecting macroeconomic stability during most of the study period. Economic growth, however, exhibited greater volatility, as indicated by a higher standard deviation and the presence of negative growth in 2020. This variability suggests that economic shocks may influence fiscal conditions, although not necessarily in a linear or direct manner.

4.3 Spearman Rank Correlation Analysis

Table 4. 2 Spearman Rank Correlation Test Results

Variable	CD	INF	PE
Financial Performance (KK)	1.000	0.224	0.103
Sig. (2-tailed)	-	0.533	0.777
N	10	10	10
Inflation (INF_1)	0.224	1.000	-
Sig. (2-tailed)	0.533	-	-
N	10	10	-
Economic Growth (PE_2)	0.103	-	1.000
Sig. (2-tailed)	0.777	-	-
N	10	-	10

Source : SPSS 25 2025 Data Processing Results

Note: Values represent Spearman correlation coefficients; significance is reported at the 5% level (two-tailed).

Variables	Financial Performance	Inflation	Economic Growth
Financial Performance	1.000	0.224	0.103
Sig. (2-tailed)	–	0.533	0.777
N	10	10	10

The Spearman rank correlation results indicate that inflation has a positive but weak relationship with financial performance (ρ = 0.224), with a probability value of 0.533, suggesting that the relationship is statistically insignificant. Similarly, economic growth shows a very weak positive correlation with financial performance (ρ = 0.103) and is also statistically insignificant (p = 0.777).

These findings imply that neither inflation nor economic growth has a strong or direct association with the financial performance of the Makassar City Government during the study period. Consequently, improvements in macroeconomic indicators do not automatically translate into enhanced fiscal efficiency at the regional government level.

4.4 Discussion

4.4.1 Inflation and Local Government Financial Performance

The empirical results reveal that inflation has a positive but weak and statistically insignificant relationship with the financial performance of the Makassar City Government. This finding does not fully support Musgrave's (1959) public finance theory, particularly the fiscal stabilization function, which emphasizes the government's role in maintaining price stability to ensure efficient fiscal management.

From a theoretical perspective, rising inflation is expected to increase government expenditure due to higher input costs and public service prices, potentially reducing fiscal efficiency. However, the empirical evidence from Makassar City shows an inconsistent pattern. In several years, decreases in inflation were accompanied by declines in financial performance, while in other years, reduced inflation coincided with improved fiscal efficiency. This inconsistency suggests that inflation alone is not a decisive determinant of regional financial performance.

Keynesian theory provides additional insight by emphasizing that uncontrolled inflation can erode purchasing power and increase fiscal pressure. Nevertheless, the weak empirical relationship observed in this study indicates that Makassar City's fiscal structure mitigates the impact of inflation on financial performance. A major explanatory factor is the city's heavy reliance on intergovernmental transfers, such as the General Allocation Fund (DAU) and the Special Allocation Fund (DAK). These transfers provide fiscal stability and reduce the sensitivity of local budgets to inflationary fluctuations.

This finding aligns with previous studies reporting insignificant effects of inflation on regional financial performance, although it contrasts with research suggesting a positive and significant relationship. Such differences highlight the importance of regional fiscal characteristics and policy contexts in shaping the inflation–performance nexus.

4.4.2 Economic Growth and Local Government Financial Performance

The results also indicate that economic growth has a very weak and statistically insignificant relationship with financial performance. Although trend analysis suggests that periods of economic expansion are sometimes followed by improvements in financial performance, this pattern is not consistent enough to produce a strong statistical relationship.

According to Musgrave's allocation function, economic growth should enhance fiscal capacity by increasing regional tax revenues and improving budget efficiency. However, in the case of Makassar City, economic growth has not been fully translated into improved financial performance. This outcome can be attributed to structural economic characteristics, particularly the dominance of the informal sector, which contributes relatively little to Regional Original Revenue (PAD).

Furthermore, limitations in investment absorption, suboptimal utilization of productive sectors, and inefficiencies in revenue administration reduce the fiscal benefits of economic growth. As a result, economic expansion does not automatically lead to improved fiscal efficiency in the short term.

These findings are consistent with prior empirical studies indicating that economic growth does not necessarily improve local government financial performance, especially when structural constraints and institutional inefficiencies persist. The time lag required for economic growth to be transformed into fiscal capacity further explains the weak observed relationship.

4.5 Synthesis

Overall, the results demonstrate that macroeconomic indicators such as inflation and economic growth play a limited role in explaining variations in the financial performance of the Makassar City Government. Internal fiscal management, institutional capacity, and revenue structure appear to be more critical determinants of regional financial efficiency than macroeconomic conditions alone.

5. Closing

5.1 Summary of Findings

This study examined the relationship between inflation, economic growth, and the financial performance of the Makassar City Government over the period 2015–2024. The empirical results based on Spearman correlation analysis indicate that inflation has a positive but weak and statistically insignificant relationship with local government financial performance. Similarly, economic growth shows a very weak and insignificant association with financial performance. These findings suggest that variations in macroeconomic indicators do not directly translate into improvements in fiscal efficiency at the regional government level.

5.2 Theoretical Implications

From a theoretical perspective, the findings provide limited support for public finance theory, particularly Musgrave's allocation and stabilization functions. While economic theory suggests that stable inflation and positive economic growth should enhance fiscal capacity and efficiency, the empirical evidence from Makassar City indicates that such relationships are weak. This implies that macroeconomic stability alone is insufficient to improve local government financial performance without effective fiscal institutions and governance mechanisms.

5.3 Policy Implications

The results highlight the importance of strengthening internal fiscal management rather than relying solely on macroeconomic conditions. Local governments should focus on improving budget efficiency, expenditure quality, and revenue management to enhance financial performance. Furthermore, high dependence on intergovernmental transfers may reduce the sensitivity of local fiscal performance to changes in inflation and economic growth, suggesting the need to increase regional fiscal autonomy and optimize local revenue sources.

5.4 Limitations of the Study

This study is subject to several limitations. First, the analysis is based on a relatively small number of observations, which may limit the statistical power of the results. Second, the use of correlation analysis does not allow for causal inference. Third, financial performance is measured using a single efficiency ratio, which may not fully capture the multidimensional nature of local government fiscal performance.

5.5 Directions for Future Research

Future studies are encouraged to incorporate additional explanatory variables such as regional investment, unemployment, poverty levels, and the Human Development Index (HDI) to better capture socio-economic dynamics. Employing more advanced analytical methods, including multiple regression, panel data models, or vector autoregression (VAR), may provide deeper insights into causal relationships and long-term fiscal dynamics. Expanding the study to multiple regions would also enhance the generalizability of the findings.

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