The role of integrated fiscal policy in increasing private sector participation and regional economic growth

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Abstract

This study analyses the influence of tax incentives, public infrastructure spending, and subsidies on regional economic growth in Baubau City through the mediating role of private sector participation. The main issue concerns the effectiveness of fiscal policy in encouraging private sector involvement to support regional economic development. The research employs a mixed methods approach with an explanatory sequential design, combining quantitative analysis using SEM-PLS and qualitative analysis. Data were collected from 100 respondents, including fiscal officials, micro, small, and medium enterprise actors, and private stakeholders. The findings show that tax incentives, public infrastructure spending, and subsidies significantly affect private sector participation and regional economic growth. Private sector participation also mediates the relationship between the three fiscal instruments and economic growth. The novelty of this study lies in the integrated analysis of these three fiscal instruments and the inclusion of internal tax incentives for civil servants, such as employee additional income, which has rarely been discussed in previous studies. The results emphasize that evidence-based fiscal policy and public–private collaboration is crucial for developing effective and inclusive regional development strategies.

Keywords: *tax incentives, public infrastructure spending, subsidies, private sector participation, regional economic growth*

Introduction

Regional economic growth is one of the main indicators of development success, reflecting a region's ability to sustainably improve community welfare. In the context of modern economic development, this growth depends not only on the role of the state but also requires the active involvement of the private sector as a driving force for productivity, investment, and job creation. Therefore, synergy between government policies and private sector participation is needed to encourage inclusive and sustainable regional development. Within the framework of fiscal decentralization, local governments have broad authority to manage public revenues and expenditures. According to the Fiscal Decentralization Theory, fiscal decision-making at the local level allows for more efficient resource allocation because it is closer to community preferences (Oates, 2006). Local governments are required to design and implement effective fiscal policies to create a conducive investment climate and strengthen local economic competitiveness (Li et al., 2024).

Various fiscal instruments that can be used in this regard include tax incentives, public infrastructure spending, and subsidies (Kusumaningtyas et al., 2023). These three instruments play a strategic role in attracting private sector participation and stimulating economic activity. The Tax Incentive Theory explains that providing fiscal incentives can

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lower investment costs and increase profit expectations, thereby encouraging businesses to invest (Cho & Yoon, 2023). Meanwhile, the Public Investment Theory emphasizes that spending on public infrastructure, such as roads, water networks, and electricity, has a multiplier effect on economic growth by increasing productivity and efficiency (Aschauer, 2021). Subsidies, when directed toward productive sectors, can serve as an economic buffer and a driver of innovation and competitiveness (Czarnitzki & Hussinger, 2024).

Baubau City, as a developing city in Southeast Sulawesi, has implemented various fiscal incentive schemes. These policies include performance-based incentives such as the Employee Income Supplement for civil servants to improve the performance of the fiscal bureaucracy, the allocation of infrastructure spending to improve regional connectivity, and the facilitation of partnership programs with the private sector through Corporate Social Responsibility (CSR). However, the effectiveness of this combination of fiscal policies on increasing private sector participation and regional economic growth has not been comprehensively studied at the local level (Vranic et al., 2021). This raises critical questions about the extent to which these fiscal instruments have successfully driven inclusive and sustainable economic growth (Ansar et al., 2020). To date, most previous literature has focused on the partial impact of fiscal policy. Research by Mogro (2023) found that the impact of tax incentives on investment is highly dependent on policy design and regulatory certainty (Khan et al., 2023). Meanwhile, Crowley & Sobel (2014) showed that public infrastructure spending has a positive correlation with economic activity in the Eurozone. On the other hand, Wang & Zhang (2023) assessed that fiscal subsidies are effective when directed toward productive sectors and combined with other incentives.s

In a recent study, Cantarero & Gonzalez (2020) developed the concept of Local Fiscal Performance as a Determinant of Independent Growth, emphasizing the importance of effective regional fiscal management in driving economic growth. Their research findings indicate that the fiscal independence ratio has a positive and significant impact on regional economic growth, while fiscal decentralization that is not balanced with productive investment can actually have a negative impact (Tanzi & Davoodi, 2019). This means that tax incentives, public infrastructure spending, and subsidies will only be effective if designed within a framework of quality fiscal independence and well-targeted budget allocation. This theory supports the need for public infrastructure spending and subsidies to be directed toward sectors that can foster productivity and private sector participation, rather than simply being consumptive or populist. Therefore, the role of local fiscal institutions is crucial in ensuring that each policy instrument can deliver maximum and sustainable economic effects.

Studies that simultaneously integrate all three fiscal instruments in a local context are still limited, particularly in a mid-sized city like Baubau. At the national level, research on the impact of fiscal policies such as tax incentives, public infrastructure spending, and subsidies on private sector participation remains limited, despite their significant relevance for boosting economic growth. In many countries, particularly in Southeast Asia, fiscal incentive policies are often used to attract investment, enhance competitiveness, and accelerate regional development. For example, a study by Mogro (2023) found that well-designed tax incentives can increase foreign direct investment (FDI) flows and boost economic growth in developing countries. However, little research integrates these three fiscal instruments at the local and regional levels, a gap that needs further exploration.

At the international level, a similar phenomenon is evident in the existing literature. Aschauer (2021), in his theory on the impact of infrastructure spending on economic growth, demonstrated that public spending on infrastructure can significantly increase economic productivity and efficiency. However, much international research focuses on the influence of each fiscal policy separately, while few examine the simultaneous impact of all three, particularly in the context of mid-sized cities. Research by Mogro (2023) and Crowley & Sobel (2014) also highlights how subsidies and tax incentives affect investment, but they have not comprehensively examined how the three interact to drive regional economic growth. This research gap highlights the need for a more comprehensive and contextual approach to understanding the relationship between fiscal policy, private sector participation, and regional economic growth.

This study uses a mixed-methods approach with an explanatory sequential design model, beginning with quantitative analysis and continuing with qualitative exploration to deepen understanding. The objective of this study is to analyze the influence of tax incentives, public infrastructure spending, and subsidies on private sector participation and their impact on regional economic growth in Baubau City. The results of this study are expected to provide theoretical and practical contributions in formulating evidence-based fiscal policies that are more adaptive to regional development needs.

Methods

The population in this study includes private sector actors (MSMEs, local investors, and business actors in trade, services, and industry) as well as local government officials involved in fiscal policy. The quantitative sample was drawn using purposive sampling of 100 respondents from civil servants and business actors in trade, services, industry, and the private sector. Meanwhile, qualitative informants were selected purposively based on their involvement in fiscal management and investment in Baubau City.

The data applied in this study were analyzed using two approaches, namely quantitative analysis and qualitative analysis, which were carried out in an integrated manner within a mixed-method framework. For quantitative analysis, the Partial Least Squares-based Structural Equation Modeling (PLS-SEM) technique was used with the help of SmartPLS software. The analysis stage began with the outer model testing, which included convergent validity testing through outer loading and Average Variance Extracted (AVE) values, as well as construct reliability testing through Cronbach's Alpha and Composite Reliability values. Next, discriminant validity testing was carried out using the Fornell-Larcker criteria and cross-loading analysis to ensure that each construct was empirically different.

After the measurement model was validated, an inner model test was conducted to analyze the relationships between latent variables. This test involved calculating the coefficient of determination (R^2) to assess the model's predictive power, a multicollinearity test using the Variance Inflation Factor (VIF) value, and a bootstrapping procedure to test the significance of the influence between variables. The bootstrapping results presented path coefficients, t-statistics, and p-values, which were used to test hypotheses and determine significant relationships between constructs. Model interpretation was based on a T value > 1.96 and $p < 0.05$ as criteria for significance at the 95% confidence level. Meanwhile, a qualitative analysis was conducted to strengthen and explain the quantitative

results, using thematic analysis techniques. Interview data were analyzed through data reduction, categorization, and interpretation of informant responses. The validity of the qualitative data was strengthened through source triangulation and confirmation of results with key informants (member checking). The integration of quantitative and qualitative results was carried out in the interpretation stage, resulting in a deeper understanding of the effectiveness of regional fiscal policy in encouraging private sector participation and economic growth.

After validating the measurement model, the inner model was assessed to test the structural relationships among latent variables. The equations are specified as follows:

Mediation Model (PSP):

$$Z = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon_1 \quad (1)$$

Where Z is the Private Sector Participation, β0 is a constant, b1, b2 and b2 are regression coefficients, X1 is tax incentives , X2 is public Infrastucture spending, X3 is subsidy and ε is the error term.

Regional Economic Growth (REG):

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon_1 \quad (2)$$

Where Y is the, regional economic growth β0 is a constant, b1, b2 and b2 are regression coefficients, X1 is tax incentives , X2 is public Infrastucture spending, X3 is subsidy, X4 is Private Sector Participation and ε is the error term.

This study employed a mixed-methods approach with a sequential explanatory design, beginning with quantitative analysis and continuing with a qualitative approach to strengthen and deepen the interpretation of statistical findings. The aim of this approach was to gain a comprehensive understanding of the influence of tax incentives, public infrastructure spending, and subsidies on private sector participation and regional economic growth. In the quantitative stage, data were analyzed using Partial Least Squares-based Structural Equation Modeling (PLS-SEM) with the aid of SmartPLS version 4 software. PLS-SEM was chosen because it is suitable for complex causal models, does not require normally distributed data, and remains optimal for relatively small sample sizes (Hair et al., 2023).

The data analysis process in PLS-SEM is carried out in two main stages: testing the measurement model (outer model) and the structural model (inner model). In the outer model, the validity and reliability of the latent constructs are evaluated using the outer loading value (with a minimum threshold of 0.6), Average Variance Extracted (AVE ≥ 0.5) to measure convergent validity, and Composite Reliability and Cronbach's Alpha (with an ideal value ≥ 0.7) to assess the internal reliability of the indicators. Discriminant validity testing is conducted using the Fornell-Larcker criteria and cross-loading to ensure that each construct is truly unique and does not overlap with other constructs (Sarstedt et al., 2022).

Next, inner model testing was conducted to evaluate the causal relationships between constructs by referring to the path coefficient, t-statistic (>1.96), and p-value (<0.05) values based on the bootstrapping procedure. Furthermore, a coefficient of determination (R^2) analysis was performed to assess the model's predictive power, as well as a Variance

Inflation Factor (VIF) analysis to ensure the absence of multicollinearity among the independent variables. The results of the Model Fit Summary test were evaluated using the Standardized Root Mean Square Residual (SRMR), d_ULS, and Normed Fit Index (NFI) indicators. Although not the primary focus in PLS-SEM, model fit is still used as a supporting indicator of overall model suitability (Hair et al., 2021).

In the qualitative stage, data were analyzed using thematic analysis techniques, namely by conducting data reduction, categorization, and drawing conclusions from in-depth interviews with key informants such as regional fiscal officials and business actors. Qualitative results were used to interpret and further explain the quantitative results, thus providing a comprehensive and contextual picture of the effectiveness of fiscal policy. To ensure the validity of the results, source triangulation and data confirmation were conducted through member-checking.

By combining PLS-SEM and thematic qualitative analysis, this study was able to capture both the statistical and contextual dimensions of the relationships between the studied variables. This combination also provides a strong basis for formulating evidence-based fiscal policy recommendations tailored to the local conditions of Baubau City.

Result and Discussions

To support the validity and depth of the analysis, this study involved 100 respondents consisting of State Civil Apparatus, state-owned enterprise employees, and business/private sector actors. The selection of respondent proportions was based on the research focus, which emphasizes the influence of regional fiscal policy, particularly PAD-based tax incentives, public infrastructure spending, and subsidies on private sector participation and regional economic growth in Baubau City. Of the total respondents, 55% were business actors, who represent the main stakeholders as well as the primary targets of development and facilitation policies. Meanwhile, 40% of respondents were ASN, given their direct involvement in the implementation of fiscal policies, including as recipients of Employee Income Supplements. The remaining 5% were BUMN employees, representing the non-APBD public economic sector.

In addition to occupation, this study also included other demographic variables such as gender, age, highest level of education, and length of employment or business experience. This demographic information is necessary to understand the respondents' backgrounds, which may influence their perceptions and experiences regarding the implementation of fiscal policy instruments at the regional level. Table 1 presents the demographic details of the study respondents.

The composition of the majority of business actor respondents indicates that fiscal policies related to tax incentives are highly relevant, as business actors are the main stakeholders who directly experience the impact of regional fiscal policies. Demographic information also shows that most respondents have a relatively high level of education, which may influence their ability to understand and assess the impact of fiscal policies, thereby providing deeper insights into their evaluations of these policies.

Construct reliability testing aims to assess the internal consistency of indicators within a construct. Good reliability is reflected in Composite Reliability (CR) and Cronbach's Alpha values, each of which is above the threshold of 0.7. Composite Reliability is considered superior because it does not assume equal indicator weights, making it more suitable for

the PLS-SEM approach (Hair et al., 2021). Furthermore, Average Variance Extracted (AVE) is also used to measure convergent validity, with an ideal value above 0.5. The results of the construct reliability testing in this study can be seen in Table 2.

Table 1. Demographics and Respondents' Characteristics Data Result

Category	Sub-Category	Number of Respondents	Percentage (%)
Type of work	Civil servants	40	40%
	State-owned enterprise employees	5	5%
	Business actors/ private sector	55	55%
Gender	Male	58	58%
	Female	42	42%
Age	< 30 years	15	15%
	30–39 years	35	35%
	40–49 years	30	30%
	≥ 50 years	20	20%
Last education	High School/Vocational School	10	10%
	Diploma (D1–D3)	15	15%
	Bachelor (S1)	60	60%
	Postgraduate (S2/S3)	15	15%
Length of Work / Business	< 5 years	20	20%
	5–10 years	40	40%
	11–15 years	25	25%
	> 15 years	15	15%

Table 2. Construct Reliability and Validity

Construct	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
Public Infrastructure Spending (X2)	0.892	0.895	0.928	0.767
Tax Incentives (X1)	0.767	0.795	0.846	0.582
Regional Economic Growth (Y)	0.735	0.740	0.836	0.562
Private Sector Participation (Z)	0.837	0.846	0.892	0.675
Subsidies (X3)	0.781	0.803	0.859	0.605

Based on the results of instrument testing through Cronbach's Alpha, Composite Reliability, and Average Variance Extracted (AVE) values, all variables in this study showed a good level of reliability and convergent validity. The Public Infrastructure Spending variable (X2) has a Cronbach's Alpha value of 0.892, Composite Reliability of 0.928, and AVE of 0.767. These three values indicate that the construct is highly reliable and valid because it exceeds the recommended threshold, which is > 0.70 for reliability and > 0.50 for AVE.

Similarly, the Tax Incentive variable (X1) shows adequate results with a Cronbach's Alpha of 0.767, Composite Reliability of 0.846, and AVE of 0.582, which also meets the criteria set by Hair et al (2021).

Furthermore, the Regional Economic Growth (Y) variable obtained a Cronbach's Alpha value of 0.735, Composite Reliability of 0.836, and AVE of 0.562. Although at the lower limit, these values remain within the acceptable range, indicating that this construct is quite reliable and valid. The Private Sector Participation (Z) variable also showed excellent results with a Cronbach's Alpha of 0.837, Composite Reliability of 0.892, and AVE of 0.675. Meanwhile, the Subsidy (X3) variable obtained a Cronbach's Alpha value of 0.781, Composite Reliability of 0.859, and AVE of 0.605, indicating an adequate level of reliability and validity. Overall, these test results indicate that all constructs in the research model have met the requirements for convergent validity and internal reliability.

High reliability and validity indicate that the instruments used to measure variables such as tax incentives, infrastructure spending, and subsidies are trustworthy for assessing the impact of fiscal policy on economic growth and private sector participation. Reliable and valid constructs enable this study to employ dependable data for further analysis and provide a solid foundation for linking fiscal policy to economic outcomes in Baubau. Therefore, the instrument used in this study is declared suitable and can be used for the next stages of structural analysis, such as discriminant validity testing, inner model analysis, and moderated regression testing.

Discriminant validity testing is conducted to ensure that each construct in the model is truly empirically different from the other constructs. Discriminant validity can be assessed through two main approaches, namely the Fornell-Larcker criterion and Cross Loading analysis. In the Fornell-Larcker criterion, a construct is declared discriminantly valid if the square root of the AVE (Average Variance Extracted) value is greater than the correlation between other constructs (Fornell & Larcker, 1981). Meanwhile, through cross loading, discriminant validity is achieved if each indicator has the highest loading on the measured construct compared to other constructs (Hair et al., 2023). The results of the discriminant validity test in this study are presented in Table 3.

Table 3 shows the discriminant validity in this study was analyzed using the Fornell-Larcker Criterion approach, which aims to see whether each construct is truly different from other constructs. Discriminant validity is considered fulfilled if the square root of the AVE (listed in the diagonal section of the table) is greater than the correlation value between other constructs. The test results show that Public Infrastructure Spending (X2) has an AVE root value of 0.876, higher than its correlation with Tax Incentives (0.363), Regional Economic Growth (0.535), Private Sector Participation (0.543), and Subsidies (0.502). This indicates good discriminant validity. Tax Incentives (X1) also demonstrated discriminant validity, with an AVE root value of 0.763, greater than its correlation with Regional Economic Growth (0.720) and Subsidies (0.490), although the difference was quite small with variable Y. Similarly, Regional Economic Growth (Y) had an AVE root value of 0.750, greater than its correlation with Private Sector Participation (0.720) and Subsidies (0.612). Private Sector Participation (Z) recorded an AVE root value of 0.822, higher than its highest correlation with variable Y (0.720). Finally, Subsidies (X3) had an AVE root value of 0.778, greater than its correlation with all other variables. With these results, all constructs in the study met the criteria for discriminant validity. This means that each variable was able to

distinguish itself from the other variables convincingly. This indicates that the measurement model used in the study has strong validity.

Table 3. Fornell Lacker Criterion Test

	Public Infrastructure Spending (X2)	Tax Incentive Opinion (X1)	Regional Economic Growth (Y)	Private Sector Participation (Z)	Subsidies (X3)
Public Infrastructure Spending (X2)	0.876				
Tax Incentive Opinion (X1)	0.363	0.763			
Regional Economic Growth (Y)	0.535	0.720	0.750		
Private Sector Participation (Z)	0.543	0.505	0.720	0.822	
Subsidies (X3)	0.502	0.490	0.612	0.572	0.778

Public infrastructure spending proved to have the highest value in this study for several key reasons. First, good infrastructure, such as roads, bridges, and transportation facilities, can increase economic efficiency and productivity by reducing operational costs and accelerating the distribution of goods and services, which directly attracts private sector investment. As explained by Aschauer (2021) adequate infrastructure can increase economic productivity and efficiency. Furthermore, infrastructure spending creates a multiplier effect, where infrastructure development stimulates other sectors such as construction and manufacturing, contributing to sustainable economic growth (Goh & Wong, 2019) Infrastructure spending can also increase regional competitiveness by creating a more favorable business climate, as found in the (Camino-Mogro, 2023) study. Overall, public infrastructure spending plays a central role in stimulating the private sector and economic growth, both in the short and long term.

The next step in the data processing stage is to conduct an internal model analysis. The testing stage involves observing the R-square and Q-square values of the established measurement model framework. Based on the data processing stages, the results are presented in Table 4 below.

Table 4. R Square

	R Square	R Square Adjusted
Private Sector Participation (Z)	0.461	0.444
Regional Economic Growth (Y)	0.706	0.697

Table 4 shows the analysis of the structural model or inner model is carried out by looking at the R Square (R^2) and Adjusted R Square values, which show how much the independent variables are able to explain the dependent variable. Based on the results of data processing, the R Square value for the Private Sector Participation (Z) variable was

obtained at 0.461, which means that 46.1% of the variability in private sector participation can be explained by the independent variables in the model, while the remaining 53.9% is influenced by other factors outside the model. The Adjusted R Square value of 0.444 indicates an adjustment to the number of predictors in the model, and remains in the moderate category, which indicates a sufficient contribution from exogenous variables to the Z variable. However, the lower R^2 value for private sector participation (0.461) indicates that although fiscal policy has a significant influence, there are other factors outside this model that also influence private sector participation, such as social, cultural, or other non-fiscal policy factors.

Meanwhile, the R Square value for the Regional Economic Growth (Y) variable is 0.706, meaning that 70.6% of the change in regional economic growth can be explained by private sector participation and other variables used in the model. This value indicates high predictive power, as it is above 0.70. The Adjusted R Square for the Y variable of 0.697 also indicates excellent model stability, and only experienced a slight reduction after being adjusted for the number of predictors. Thus, both dependent variables in this model have a good level of clarity of variation, especially the Regional Economic Growth variable, which indicates that this research model is able to explain the phenomena studied strongly and relevantly. The summary of the results of the instrument testing and the structural model (inner model) in this study can be observed through the measurement framework used. The image of the measurement framework in question can be seen in Figure 1 below:

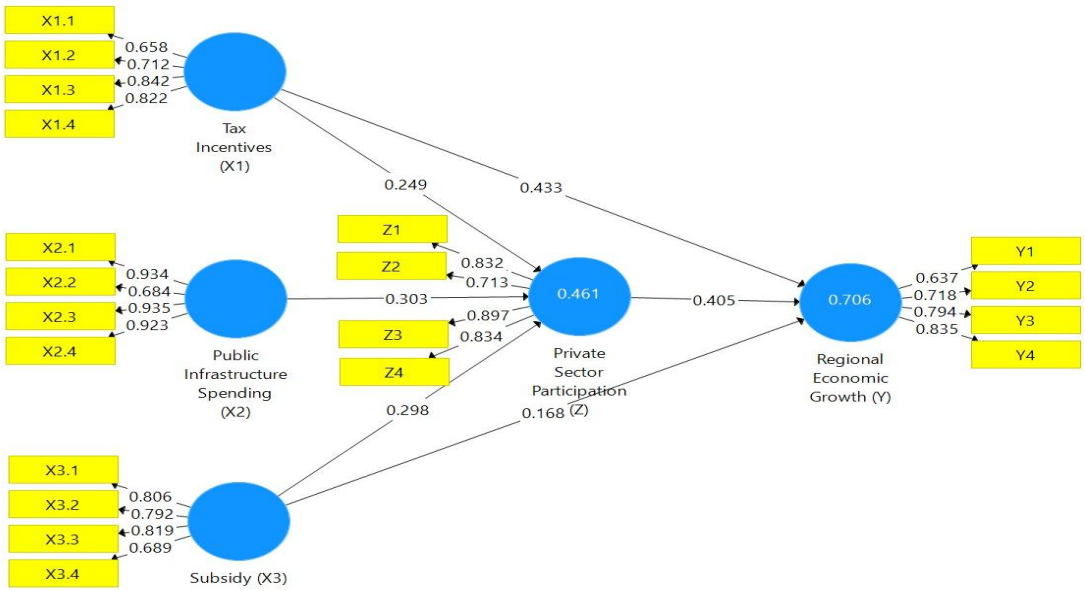

Figure 1. Full Research Model

The Outer Model Testing aims to evaluate the reliability and validity of the indicators in representing the latent constructs studied. This evaluation includes three main aspects, namely convergent validity, construct reliability, and discriminant validity. Convergent validity is seen through the outer loading value, Average Variance Extracted (AVE), and Composite Reliability. Based on the image of the measurement model used, all indicators in the latent construct show outer loading values that are generally above the minimum threshold of 0.70, indicating that these indicators are able to explain the construct adequately. In the Tax Incentive construct (X1), the outer loading value ranges from 0.658

to 0.842, where even though X1.1 is slightly below 0.70, this value is still acceptable as long as the AVE and reliability of the construct remain strong. The Public Infrastructure Spending construct (X2) shows excellent performance with three indicators having loading values above 0.90, indicating high measurement strength. For the Subsidy construct (X3), loading values ranged from 0.689 to 0.819, and all met convergent validity criteria. The Private Sector Participation construct (Z) demonstrated high consistency with loading values ranging from 0.71 to 0.897, while the Regional Economic Growth construct (Y) had loading values between 0.637 and 0.835, indicating a significant contribution to their respective constructs.

In terms of construct reliability, the Composite Reliability and Cronbach's Alpha values for all constructs exceeded 0.70, indicating good internal consistency. This confirms that each construct in this model reliably measures the concept it represents. Furthermore, discriminant validity was also met based on the Fornell-Larcker criterion, where the square root of the AVE of each construct is greater than the correlation between the other constructs. Thus, this measurement model is declared valid and reliable for use in the next stage of analysis, namely testing the structural model (inner model).

The following presents the results of hypothesis testing using the Structural Equation Modeling (SEM) approach with the Partial Least Squares (PLS) method through bootstrapping. This test aims to determine the extent of direct and indirect influences between variables in the research model, both significant and insignificant influences. The SEM PLS (Bootstrapping) output results are presented in the visual output form in Figure 2.

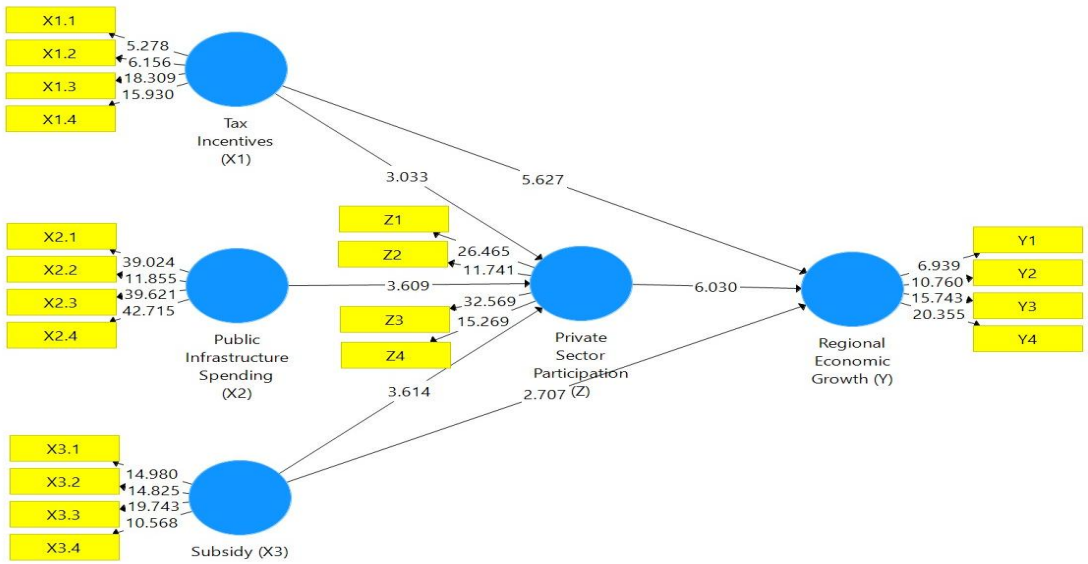

Figure 2. Hypothesis Testing

Based on the results of hypothesis testing using the bootstrapping method in the SEM-PLS model above, all relationships between latent variables show a positive and significant influence. This is indicated by a T-statistic value greater than 1.96, which means each relationship is significant at the 95% confidence level. First, the relationship between tax incentives (X1), which in this context is defined as the employee's additional income based on performance achievement, and private sector participation (Z) shows a T-statistic of 3.033, which is significant. This is in accordance with the Tax Incentive Theory, which states that tax incentives can reduce investment costs and increase profit expectations for

business actors, which ultimately encourages them to invest more (Cho & Yoon, 2023). This also shows that providing internal incentives to employee's can encourage improved performance in PAD management, which ultimately has a positive impact on increasing private sector trust and participation in regional development activities.

Furthermore, tax incentives (X1) also have a direct and significant effect on regional economic growth (Y) with a T-statistic of 5.627. This means that such incentives not only increase PAD but also strengthen the driving force for regional economic growth directly. The results show that tax incentives not only have a direct impact on economic growth but also act as a strengthening factor in the influence of private sector participation on economic growth. Research by Khan, Jan, & Shah (2023) confirms that well-designed tax incentive policies can facilitate more active private sector investment, which in turn accelerates economic growth.

Then, public infrastructure spending (X2) is proven to have a significant effect on private sector participation (Z) with a T-statistic of 3.609. This indicates that government infrastructure development, such as roads, public facilities, or public services, can create a more attractive investment environment for the private sector to actively participate. The results show that effective public infrastructure spending, such as the construction of roads, bridges, or public facilities, has a positive and significant impact on increasing private sector participation. This is consistent with Aschauer (2021) findings, which state that infrastructure spending significantly impacts economic productivity by creating a more conducive environment for economic activity. Good infrastructure reduces operational costs and increases the efficiency of the distribution of goods and services, which in turn attracts private sector investment.

Meanwhile, subsidies (X3), defined in this study as CSR assistance from the private sector to local governments and from the government to MSMEs, also have a significant influence on private sector participation (Z), with a T-statistic of 3.614. Collaborative and transparently managed CSR assistance can build trust between the private sector and the government and increase private sector participation in development. The results of this test indicate that subsidies (X3), whether in the form of government assistance to the private sector through Corporate Social Responsibility (CSR) programs or direct subsidies to MSMEs, have a significant influence on private sector participation (Z). Appropriate subsidy programs can increase the competitiveness and capacity of the private sector to innovate and develop, which ultimately increases their participation in economic activities. Research by Czarnitzki, D., & Hussinger (2024) also found that well-targeted subsidies can encourage the private sector to increase its innovation and competitiveness, and contribute to economic growth.

The private sector participation variable (Z) itself makes a very strong contribution to regional economic growth (Y), as evidenced by a T-statistic of 6.030, the highest value among the other relationships. This confirms that the private sector plays a key role in driving economic growth through investment, job creation, and increased productivity. The results showing a high T-statistic confirm that private sector participation has a very strong influence on regional economic growth. Private sector involvement in the form of investment, job creation, and increased productivity can drive higher economic growth, which is consistent with the Economic Growth Theory which states that the contribution of the private sector in economic development plays an important role in creating favorable

conditions for long-term economic growth (Barro, 2021). In addition, Petreski & Olczyk (2025) highlight the importance of the private sector in driving economic growth through direct investment and job creation.

Subsidies CSR also show a significant influence on regional economic growth, with a T-statistic of 2.707. Although its influence is not as strong as other variables, CSR still contributes positively, especially when directed at strategic sectors such as education, health, and local infrastructure. Overall, the bootstrapping results indicate that all hypotheses proposed in this study are accepted, and all relationships between latent variables are statistically significant. These findings reinforce the idea that a combination of incentive-based policies, infrastructure development, and CSR partnerships is an effective strategy for increasing private sector participation while simultaneously driving sustainable regional economic growth. This is in line with the findings of Czarnitzki, D., & Hussinger (2024), which show that R&D and CSR subsidies can increase competitiveness and innovation in the private sector, which then drives economic growth through greater investment and increased production capacity.

Conclusion

This study concludes that regional fiscal policy plays an essential role in encouraging private sector participation and economic growth in Baubau City. In addition to performance-based Employee Income Supplements for civil servants, local tax incentives are also provided to Micro, Small, and Medium Enterprises (MSMEs) through government support. These incentives are not given in direct funds but in the form of priority and preference, such as directing government events to use local MSME products. Such incentives not only encourage tax compliance but also expand market opportunities and economic access.

Public infrastructure spending contributes to production and distribution efficiency, while private sector Corporate Social Responsibility (CSR) programs directly enhance the productivity of MSMEs and agriculture. Moreover, private sector participation serves as a mediating variable that strengthens the link between fiscal policy and economic growth, highlighting that the success of regional development depends greatly on business involvement.Based on these findings, regional governments are recommended to strengthen performance-based incentives for both employee's and MSMEs, focus infrastructure spending on strategic projects, align CSR with development agendas, expand private sector participation in planning and investment forums, and design fiscal policies based on transparency, efficiency, participation, and evidence-based approaches. With this strategy, fiscal policy is expected not only to stimulate private sector participation but also to reinforce fiscal capacity and promote inclusive, long-term economic growth.

This study has several limitations. First, the sample size is limited to Baubau City, making the results not fully generalizable to other regions. Second, the measurement variables are limited to tax incentives, infrastructure spending, subsidies, and private sector participation, without considering other external factors such as monetary policy or human resources. Third, despite using mixed methods, this study is still limited in exploring more complex dynamics, such as the impact on the informal sector. Furthermore, secondary data collected from a limited number of respondents may affect the objectivity of the study's results.

For future research, it is recommended to expand the research location by comparing different regions or countries to examine variations in the impact of fiscal policy. Research should also consider external variables that can influence economic growth. A longitudinal approach can be used to study the long-term impact of fiscal policy, as well as extend the analysis to the often-overlooked informal sector. Furthermore, cross-country studies can provide a broader perspective on the effectiveness of fiscal policy across contexts.

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