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Intergovernmental Fiscal Transfers and Regional Economic Growth in East Java Regencies During Pandemic Recovery

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Abstract

Fiscal decentralization is expected to strengthen regional fiscal capacity, but its growth implications remain empirically contested. This study examines the association between the General Allocation Fund, Special Allocation Fund, Revenue Sharing Fund, Village Fund, and economic growth across 29 regencies in East Java during 2018–2022. Economic growth is measured by the annual growth rate of gross regional domestic product at constant 2010 prices, while fiscal transfer variables are measured using realized transfer values and transformed into natural logarithms. Using panel data regression and fixed effects estimation, the results show that the General Allocation Fund and Revenue Sharing Fund are positively and significantly associated with regional economic growth. The Special Allocation Fund is positive but statistically insignificant, whereas the Village Fund is negative but statistically insignificant. These findings indicate that intergovernmental transfers are heterogeneous in their relationship with regional growth. The results suggest that fiscal transfer evaluation should distinguish among transfer instruments and consider transfer design, expenditure channels, local institutional capacity, and the crisis-recovery context when assessing regional growth outcomes.
Keywords: Fiscal decentralization; intergovernmental transfers; regional economic growth; East Java

JEL Classification: H71; H72; O18; R11

INTRODUCTION

Fiscal decentralization has been widely discussed as an institutional mechanism for improving allocative efficiency, local accountability, and policy responsiveness because fiscal authority is expected to be exercised closer to citizens and regional development needs (Digdowiseiso, 2022b; Farida et al., 2021). In Indonesia, fiscal decentralization is embedded in the intergovernmental fiscal framework regulated by the Law of the Republic of Indonesia Number 1 of 2022

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and operationalized through Government Regulation Number 37 of 2023 on the Management of Transfers to Regions (Indonesia, 2022, 2023). This framework places transfers to regions as a fiscal instrument to reduce vertical and horizontal fiscal imbalances, support public service delivery, and strengthen regional fiscal capacity (Indonesia, 2022, 2023; Syahrimi et al., 2025)

The effect of fiscal decentralization on economic growth remains empirically contested. Fiscal decentralization can support growth when local governments transform fiscal resources into productive expenditure, infrastructure, human capital, and local economic facilities (Digdowiseiso, 2022b; Syahrimi et al., 2025). However, its contribution may weaken when transfers generate fiscal dependence, finance routine expenditure, or operate under weak institutional capacity and limited accountability (Digdowiseiso, 2022a; Digdowiseiso et al., 2022). Empirical studies also show that decentralization outcomes are conditional on governance quality, regional capacity, expenditure effectiveness, and territorial inequality rather than on the size of transfers alone (Digdowiseiso, 2022a, 2022b; Farida et al., 2021; Wibowo & Oktivalerina, 2022).

Indonesia's transfer system consists of several instruments with different fiscal functions. The General Allocation Fund or Dana Alokasi Umum (DAU) serves an equalization function, the Special Allocation Fund or Dana Alokasi Khusus (DAK) finances specific national priorities and public service sectors, the Revenue Sharing Fund or Dana Bagi Hasil (DBH) distributes shared central revenues to eligible regions, and the Village Fund or Dana Desa supports village governance, development, community empowerment, and local economic activities (Indonesia, 2014, 2022, 2023). Because these instruments have different allocation rules, spending orientations, and development channels, treating fiscal transfers as a single aggregate measure may obscure their heterogeneous associations with regional economic growth (Farida et al., 2021; Syahrimi et al., 2025).

Previous studies in Indonesia report mixed findings regarding the relationship between fiscal transfers and economic growth. Syahrimi et al. (2025) found that regional own-source revenue, transfers to regions, human development, and investment were positively associated with real gross regional domestic product per capita. In East Java, Nurlaili (2022) showed that fiscal decentralization variables were relevant to district and municipal economic growth, but the effects differed across fiscal indicators. Other regional studies also report heterogeneous results for DAU, DAK, and DBH, suggesting that the growth effect of transfer instruments depends on fiscal design, spending structure, and local economic context (AlQomariah et al., 2022; Mokorowu et al., 2020; Sulaeman & Silvia, 2019; Trianto & Panggabean, 2023). These mixed findings create a need for a more disaggregated assessment of fiscal transfer instruments at the regency level.

The Village Fund requires specific attention because its development mechanism differs from district-level transfers. Village Fund policy is intended to support rural infrastructure, village governance, community empowerment, village-owned enterprises, and local economic activities (Indonesia, 2014, 2022, 2023; Permatasari et al., 2021). However, its empirical outcomes are not uniform. Hartojo et al. (2022) found that the Village Fund stimulated rural economic growth, particularly in lagging regions. Arifin et al. (2020) found that the Village Fund increased the number of village-owned enterprises, but this did not necessarily translate into stronger employment outcomes. Ritonga et al. (2021) also found that

the Village Fund had not consistently produced the expected effects on economic growth and poverty reduction. These findings indicate that the Village Fund may support local development, but its impact depends on targeting accuracy, governance capacity, and implementation quality (Arifin et al., 2020; Hartojo et al., 2022; Permatasari et al., 2021; Ritonga et al., 2021).

East Java provides a relevant empirical setting because it combines substantial economic activity with persistent development challenges. Badan Pusat Statistik Provinsi Jawa Timur (2023a) provides district-level gross regional domestic product data for 2018–2022 at current prices and constant 2010 prices, allowing regional economic growth to be examined across districts and over time. At the same time, Badan Pusat Statistik Provinsi Jawa Timur (2023b) reported that the number of poor residents in East Java reached 4.236 million people in September 2022, with a poverty rate of 10.49 percent. This coexistence of large economic scale and persistent poverty suggests that regional growth in East Java may not be evenly distributed or sufficiently inclusive across districts (Badan Pusat Statistik Provinsi Jawa Timur, 2023a, 2023b; Sirait & Fisabilillah, 2022).

This study focuses on 29 regencies in East Java because the Village Fund is institutionally linked to village-based fiscal arrangements. Regencies generally contain village governments as recipients and implementers of village-level development programs, whereas municipalities have more urban administrative structures and do not represent village-based fiscal implementation in the same manner. This restriction reduces institutional heterogeneity and provides a more consistent setting for examining the association between DAU, DAK, DBH, Village Fund, and regency-level economic growth.

The present study contributes to the literature in three respects. First, it provides regency-level evidence on the association between intergovernmental transfers and regional economic growth in East Java, a province characterized by large economic output and persistent poverty (Badan Pusat Statistik Provinsi Jawa Timur, 2023a, 2023b). Second, it compares four major transfer instruments simultaneously rather than treating fiscal decentralization as a single aggregate fiscal measure (Farida et al., 2021; Syahrimi et al., 2025). Third, it examines the 2018–2022 period, covering pre-pandemic conditions, the COVID-19 shock, and the early recovery phase, during which local fiscal priorities and transfer utilization patterns changed substantially (Permatasari et al., 2021; Wibowo & Oktivalerina, 2022).

Accordingly, this study examines whether DAU, DAK, DBH, and the Village Fund are associated with economic growth in 29 regencies of East Java during 2018–2022. Economic growth is measured using the growth rate of gross regional domestic product at constant 2010 prices, while fiscal transfer variables are measured using realized transfer values and transformed into natural logarithms. By applying panel data regression, this study evaluates whether variations in fiscal transfers across regencies and years are statistically associated with variations in regional economic growth.

METHOD

This study applies a quantitative explanatory design using panel data regression to examine the association between intergovernmental fiscal transfers and regional economic growth. Panel data are appropriate because the dataset combines cross-sectional variation across regencies and time-series variation across fiscal years, allowing the model to account for unobserved regional heterogeneity and temporal variation in economic performance (Baltagi, 2021; Wooldridge, 2010). The unit of analysis is the regency government in East Java Province. The population consists of 29 regencies observed during 2018–2022, producing an initial balanced panel of 145 regency-year observations. The study focuses on regencies because the Village Fund is institutionally linked to village-based fiscal arrangements, whereas municipalities have more urban administrative structures and do not represent village-based fiscal implementation in the same manner (Indonesia, 2014, 2022, 2023).

The study uses secondary data from official government sources. Economic growth is derived from gross regional domestic product at constant 2010 prices published by Badan Pusat Statistik Provinsi Jawa Timur (2023a). Fiscal transfer variables, consisting of the General Allocation Fund, Special Allocation Fund, Revenue Sharing Fund, and Village Fund, are obtained from realized transfer data published by the Directorate General of Fiscal Balance under the Ministry of Finance. Economic growth is measured as the annual growth rate of GRDP at constant 2010 prices because constant-price GRDP captures real output changes by excluding price effects across years (Badan Pusat Statistik Provinsi Jawa Timur, 2023a). The dependent variable is defined as follows:

$$PE_{it} = \frac{GRDP_{it}^{constant} - GRDP_{i,t-1}^{constant}}{GRDP_{i,t-1}^{constant}} \times 100$$

where $PE_{it}$is the economic growth rate of regency $i$in year t, $GRDP_{it}^{constant}$is the gross regional domestic product at constant 2010 prices of regency $i$in year t, and $GRDP_{i,t-1}^{constant}$is the gross regional domestic product at constant 2010 prices of regency $i$in the previous year.

The independent variables consist of four realized fiscal transfer instruments. The General Allocation Fund represents a general-purpose equalization transfer, the Special Allocation Fund represents a specific-purpose transfer for national priorities and public service sectors, the Revenue Sharing Fund represents shared central revenue allocated to eligible regions, and the Village Fund represents a village-level transfer for governance, development, empowerment, and local economic activities (Indonesia, 2014, 2022, 2023). All fiscal transfer variables are transformed into natural logarithms to reduce scale differences, mitigate right-skewness in fiscal data, and allow proportional interpretation of transfer changes (Lee, 2020). The transformation is applied only to positive-valued fiscal variables.

The empirical model is specified as follows:

$$PE_{it} = \alpha + \beta_1 \ln DAU_{it} + \beta_2 \ln DAK_{it} + \beta_3 \ln DBH_{it} + \beta_4 \ln DD_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

where $\ln DAU_{it}$, $\ln DAK_{it}$, $\ln DBH_{it}$, and $\ln DD_{it}$denote the natural logarithms of the realized General Allocation Fund, Special Allocation Fund, Revenue Sharing Fund, and Village Fund received by regency $i$in year t. The parameter αdenotes the constant, $\beta_1$to $\beta_4$denote the estimated coefficients,

$\mu_i$captures unobserved time-invariant regency-specific effects, $\lambda_t$captures year-specific effects, and ε_{it}denotes the idiosyncratic error term. Because the dependent variable is expressed in percentage points while the fiscal transfer variables are expressed in natural logarithms, the model follows a lin-log specification. Therefore, a 1 percent increase in a fiscal transfer variable is associated with an approximate change of $\beta_j/100$percentage points in economic growth, ceteris paribus (Lee, 2020).

Model selection is conducted by comparing the Common Effect Model, Fixed Effect Model, and Random Effect Model. The Chow test is used to compare the Common Effect Model and Fixed Effect Model, while the Hausman test is used to compare the Fixed Effect Model and Random Effect Model (Baltagi, 2021; Wooldridge, 2010). The Fixed Effect Model is preferred when unobserved regency-specific effects are correlated with the explanatory variables, whereas the Random Effect Model requires the assumption that unobserved regional effects are not correlated with the explanatory variables (Baltagi, 2021; Wooldridge, 2010). Diagnostic tests are conducted for multicollinearity, heteroskedasticity, and serial correlation because violations of these assumptions may distort standard errors and statistical inference (Baltagi, 2021; Wooldridge, 2010). Where necessary, robust standard errors are used to improve inference reliability.

Outlier treatment is conducted to avoid arbitrary sample exclusion. Observations are examined using standardized residuals and influence diagnostics. Observations are treated as influential only when they display extreme residual behavior and exert a disproportionate effect on estimated coefficients. After the outlier treatment, the final sample consists of 26 regencies observed over five years, producing 130 balanced panel observations. The results are interpreted as statistical associations rather than definitive causal effects because the study uses observational fiscal and economic data and may still be affected by omitted variables, reverse causality, and time-varying shocks during the pandemic period (Baltagi, 2021; Wooldridge, 2010).

RESULTS AND DISCUSSION

Descriptive Analysis

The final sample consists of 130 balanced panel observations from 26 regencies in East Java during 2018–2022 after outlier treatment. Economic growth has a mean of 3.06 percent, with a minimum of -5.85 percent and a maximum of 8.88 percent, indicating substantial variation in regional economic performance during the pre-pandemic, pandemic, and early recovery periods. The fiscal transfer variables also vary across regencies. The General Allocation Fund has the largest mean value, followed by the Special Allocation Fund, Village Fund, and Revenue Sharing Fund. These differences support the argument that intergovernmental transfers should be examined separately because each instrument has different allocation rules, fiscal functions, and development channels (Indonesia, 2022, 2023; Syahrimi et al., 2025).

Table 1. Descriptive Statistics

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Variable	Mean	Median	Maximum	Minimum	Std. Dev.	Observations
Economic Growth	3.063	4.330	8.880	-5.850	3.111	130
General Allocation Fund	985,861.400	976,620.000	1,375,780.000	731,750.000	143,678.500	130
Special Allocation Fund	345,157.100	334,705.000	568,470.000	249,580.000	59,767.860	130
Revenue Sharing Fund	145,635.100	127,155.000	407,610.000	83,070.000	60,096.330	130
Village Fund	243,046.100	235,145.000	429,200.000	103,320.000	74,230.270	130

Source: Processed by the authors from BPS Provinsi Jawa Timur and the Directorate General of Fiscal Balance, Ministry of Finance. Monetary variables are expressed in million rupiah, while economic growth is expressed in percent.

Model Selection and Regression Results

The model selection tests indicate that the Fixed Effect Model is more appropriate than the Common Effect Model and Random Effect Model. The Chow test rejects the Common Effect Model, while the Hausman test rejects the Random Effect Model. This result suggests that unobserved regency-specific characteristics are statistically relevant and may be correlated with the explanatory variables. The Fixed Effect Model is therefore appropriate because it controls for time-invariant heterogeneity across regencies, such as structural economic characteristics, administrative capacity, infrastructure stock, and local fiscal conditions (Baltagi, 2021; Wooldridge, 2010).

The fixed effect estimation shows that the fiscal transfer variables are jointly significant, as indicated by the probability of the F-statistic of 0.000008. The adjusted R-squared value of 0.3327 indicates that approximately 33.27 percent of the variation in economic growth is explained by the model after controlling for regency-specific fixed effects. The General Allocation Fund and Revenue Sharing Fund are positive and statistically significant, while the Special Allocation Fund is positive but statistically insignificant. The Village Fund is negative but statistically insignificant.

The use of the Fixed Effect Model also improves the credibility of inference because it controls for unobserved time-invariant differences across regencies. In fiscal decentralization studies, this is particularly important because local economic performance is rarely determined only by annual fiscal transfers. It is also shaped by structural conditions such as industrial base, rural-urban composition, infrastructure stock, labor market characteristics, and administrative capacity. The Fixed Effect Model therefore provides a more conservative estimation framework for examining the within-regency association between fiscal transfers and economic growth.

Table 2. Model Selection and Fixed Effect Regression Results

Test/Variable	Coefficient/Statistic	Probability	Result
Chow Test	Cross-section F	0.0094	FEM preferred
Hausman Test	Cross-section random	0.0000	FEM preferred
Constant	-517.9259	0.0000	Significant
ln General Allocation Fund	30.6634	0.0000	Positive significant
ln Special Allocation Fund	3.5291	0.1643	Positive insignificant
ln Revenue Sharing Fund	7.2063	0.0000	Positive significant
ln Village Fund	-2.5949	0.3285	Negative insignificant
R-squared	0.4827		
Adjusted R-squared	0.3327		
Prob. F-statistic	0.000008		Jointly significant

Source: Processed by the authors using EViews.

Because the independent variables are expressed in natural logarithms while economic growth is expressed in percentage points, the coefficients are interpreted as lin-log estimates rather than elasticities. A 1 percent increase in the General Allocation Fund is associated with an increase of approximately 0.3066 percentage points in economic growth, ceteris paribus. Similarly, a 1 percent increase in the Revenue Sharing Fund is associated with an increase of approximately 0.0721 percentage points in economic growth. This interpretation follows the lin-log specification and avoids overstating the magnitude of the coefficients (Lee, 2020).

Discussion

The positive and statistically significant coefficient of the General Allocation Fund indicates that DAU is associated with higher economic growth across East Java regencies after controlling for unobserved regency-specific characteristics. This finding is consistent with the equalization role of DAU in Indonesia's intergovernmental fiscal system, where general transfers are designed to strengthen regional fiscal capacity and reduce fiscal disparities across local governments (Indonesia, 2022, 2023). Empirically, the result is also in line with studies showing that fiscal transfers may support regional economic performance when they expand local governments' ability to finance public services and development expenditure (Nurlaili, 2022; Syahrimi et al., 2025). However, the positive coefficient should not be interpreted as evidence that DAU automatically produces productive expenditure. As a general-purpose transfer, DAU can finance personnel expenditure, operational spending, infrastructure, or other local programs depending on local budget decisions (Indonesia, 2022, 2023). This interpretation is supported by Prayoga and Pratama (2025), who found that personnel expenditure, goods and services expenditure, and capital expenditure were positively associated with GRDP across Indonesian regencies and cities. Their findings indicate that the growth relevance of fiscal resources depends on how regional budgets are translated into expenditure composition. Therefore, the result in this study supports the fiscal

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capacity channel, but it does not directly prove the expenditure-quality channel. Fiscal decentralization can support growth when fiscal resources are managed through productive expenditure, but its effect may weaken under routine spending dominance, weak governance, or limited institutional capacity (Digdowiseiso, 2022a, 2022b).

The Special Allocation Fund has a positive but statistically insignificant coefficient. This result suggests that DAK does not show a strong contemporaneous association with economic growth in the estimated model. The finding is plausible because DAK is a specific-purpose transfer directed toward national priorities, public services, and sectoral development programs rather than a fully flexible fiscal capacity instrument (Indonesia, 2022, 2023). Sector-specific transfers may improve infrastructure, education, health, or public service capacity, but their effects may require a longer transmission period before appearing in annual GRDP growth. Prayoga and Pratama (2025) also incorporated a time lag for capital expenditure in examining its relationship with regional economic performance, which supports the argument that development-oriented spending may not be fully captured by short-term growth indicators. Previous regional studies also report mixed results for DAK, indicating that its relationship with economic growth depends on sectoral allocation, regional absorption capacity, and the period of observation (Mokorowu et al., 2020; Nurlaili, 2022; Trianto & Panggabean, 2023). Thus, the insignificant coefficient does not necessarily mean that DAK has no developmental value. It indicates that DAK is not statistically associated with short-term GRDP growth in this model.

The Revenue Sharing Fund is positively and significantly associated with economic growth. This result is consistent with the fiscal capacity argument because DBH increases the resources available to eligible local governments and can strengthen their expenditure capacity (Indonesia, 2022, 2023). Unlike DAU, DBH is linked to shared central revenues, so its allocation may reflect differences in local revenue bases, tax bases, natural resource characteristics, and economic activity across regions (Indonesia, 2022, 2023). Pratama and Wardani (2025) showed that regional tax revenue is shaped by economic and demographic factors, including population, transportation-sector GRDP, and GRDP per capita. Their findings are relevant here because they indicate that local fiscal capacity is closely connected to the underlying economic structure of a region. The positive DBH coefficient is also consistent with empirical studies showing that regional transfer and revenue-sharing variables may be associated with regional economic performance, although the magnitude and direction can differ across local contexts (AlQomariah et al., 2022; Sulaeman & Silvia, 2019; Syahrimi et al., 2025). However, the result should still be interpreted cautiously. Because DBH may partly reflect underlying regional economic structures, the estimated relationship may contain endogeneity that cannot be fully eliminated in an observational panel design.

The Village Fund has a negative but statistically insignificant coefficient in the Fixed Effect Model. This result does not provide sufficient evidence that the Village Fund reduces economic growth. Instead, it indicates that the Village Fund is not systematically associated with higher regency-level GRDP growth during the 2018–2022 period. This finding is reasonable because the Village Fund operates at the village level, while the dependent variable in this study is measured at the

regency level. Such aggregation may weaken the ability of the model to capture village-level effects on rural infrastructure, village-owned enterprises, local employment, and household welfare (Arifin et al., 2020; Permatasari et al., 2021). Previous studies also show that Village Fund outcomes are heterogeneous. Hartojo et al. (2022) found positive effects on rural economic growth, particularly in lagging regions. Arifin et al. (2020) found that the Village Fund increased village-owned enterprises without necessarily improving employment outcomes. Ritonga et al. (2021) found that the Village Fund had not consistently produced the expected effects on growth and poverty reduction. These findings suggest that Village Fund performance depends on targeting accuracy, local economic structure, village governance quality, and implementation capacity (Permatasari et al., 2021).

The 2018–2022 period also requires careful interpretation because it covers pre-pandemic conditions, the COVID-19 shock, and the early recovery phase. During crisis periods, local fiscal priorities may shift from productive investment toward social protection, health response, emergency spending, and short-term household support (Permatasari et al., 2021; Wibowo & Oktivalerina, 2022). Pratama and Wardani (2025) also noted that the COVID-19 pandemic depressed local tax performance, which reinforces the argument that regional fiscal capacity and local economic activity were disrupted during the crisis period. This shift may weaken the immediate association between fiscal transfers and GRDP growth, especially for transfer instruments used to support crisis mitigation rather than direct production expansion. The Village Fund is particularly relevant in this context because village-level spending during the pandemic was partly redirected toward household support and local resilience programs (Permatasari et al., 2021). Therefore, the negative and insignificant Village Fund coefficient should be read as evidence of weak contemporaneous association at the regency level, not as evidence of program failure.

Overall, the findings show that intergovernmental fiscal transfers have heterogeneous associations with regional economic growth. DAU and DBH are positively and significantly associated with growth, while DAK and the Village Fund do not show statistically significant associations in the Fixed Effect Model. This pattern supports the argument that fiscal decentralization should not be evaluated only through aggregate transfer size because each transfer instrument has different allocation rules, expenditure channels, and policy objectives (Indonesia, 2022, 2023). The results also align with Prayoga and Pratama (2025), who emphasized that regional expenditure composition matters for explaining regional economic performance. From a policy perspective, transfer evaluation should distinguish between general fiscal capacity instruments, specific-purpose transfers, shared-revenue instruments, and village-level transfers. Evaluating the Village Fund only through regency-level GRDP growth may be insufficient because its outcomes may be more visible in village-level indicators such as rural employment, village-owned enterprise performance, infrastructure access, poverty reduction, and community welfare (Arifin et al., 2020; Hartojo et al., 2022; Permatasari et al., 2021).

The results should also be interpreted within the limitations of the research design. Because this study uses observational panel data, the findings indicate

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statistical associations rather than definitive causal effects (Baltagi, 2021; Wooldridge, 2010). Potential omitted variables, reverse causality, and time-varying shocks may still influence the estimated relationships. The use of regency-level data may conceal substantial variation across villages, especially because villages differ in governance capacity, infrastructure needs, economic structure, and community participation (Arifin et al., 2020; Permatasari et al., 2021). Future research should therefore compare full-sample and outlier-adjusted estimations, incorporate lagged transfer variables, include sectoral expenditure composition, and use more granular village-level data where available.

CONCLUSION

This study examines the association between the General Allocation Fund, Special Allocation Fund, Revenue Sharing Fund, Village Fund, and regional economic growth in 29 regencies of East Java during 2018–2022. The findings show that intergovernmental fiscal transfers have heterogeneous associations with regional growth. The General Allocation Fund and Revenue Sharing Fund are positively and significantly associated with economic growth, while the Special Allocation Fund is positive but statistically insignificant and the Village Fund is negative but statistically insignificant.

These results indicate that fiscal transfers should not be evaluated as a single aggregate instrument. Each transfer has different allocation rules, fiscal functions, and expenditure channels. The positive association of the General Allocation Fund and Revenue Sharing Fund suggests that general fiscal capacity remains relevant for supporting regional economic performance. However, higher transfers do not automatically generate growth because their contribution depends on expenditure quality, transfer design, local institutional capacity, and implementation effectiveness.

This study has several limitations. The use of observational panel data means that the findings should be interpreted as statistical associations rather than definitive causal effects. Potential omitted variables, reverse causality, outlier sensitivity, and the COVID-19 shock may still affect the estimated relationships. Future research should incorporate lagged transfer variables, sectoral expenditure composition, local institutional capacity indicators, and more granular village-level data. For policy evaluation, fiscal transfer reform should place greater emphasis on expenditure effectiveness, implementation capacity, and outcome-based performance monitoring.

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