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Fiscal Decentralization and Regional Economic Growth: Empirical Evidence from Indonesian Districts

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Abstract

Fiscal decentralization has become a central policy instrument in Indonesia's regional development strategy since the early 2000s. However, empirical findings on its impact on regional economic growth remain inconclusive. This study examines the effect of fiscal decentralization on economic growth across Indonesian districts by synthesizing evidence from panel data–based empirical studies and contextualizing them within decentralization theory. The study adopts a qualitative systematic review and comparative empirical synthesis approach, focusing on indicators such as regional own-source revenue, intergovernmental transfers, and government expenditure. The findings indicate that fiscal decentralization generally exerts a positive influence on regional economic growth, particularly through increased local revenue capacity and productive government spending. However, the impact varies across regions due to differences in fiscal capacity, governance quality, and dependency on central government transfers. Several studies also reveal that excessive reliance on general allocation funds may weaken growth incentives. This study contributes to the literature by integrating diverse empirical results into a coherent analytical framework and highlighting policy conditions under which fiscal decentralization promotes sustainable regional growth. The findings support the need for strengthening local fiscal autonomy while improving accountability and expenditure efficiency at the district level.

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Introduction

Fiscal decentralization has been a central pillar of Indonesia's public sector reform since the early 2000s, following the enactment of regional autonomy policies. The reform aimed to address long-standing regional disparities, improve public service delivery, and stimulate local economic growth by transferring fiscal authority from the central government to subnational governments. In theory, fiscal decentralization enhances allocative efficiency by allowing local governments to tailor public spending to regional needs and preferences. This mechanism is expected to promote economic growth through improved resource allocation and stronger local accountability (Tirtosuharto, 2010; Rustan, 1969).

In the Indonesian context, the decentralization framework grants districts and cities substantial authority over expenditure decisions, while revenue capacity remains partially constrained by central government regulations. Local governments rely on a combination of regional own-source revenue, revenue-sharing funds, general allocation funds, and special allocation funds. Empirical studies consistently emphasize that the composition and management of these fiscal instruments determine the effectiveness of decentralization outcomes. Sasana (2019) demonstrates that increased government spending, private investment, and labor absorption at the district level contribute positively to regional economic growth, highlighting the importance of effective local fiscal management. Similar conclusions are drawn by Subhan et al. (2024), who find that fiscal autonomy and intergovernmental transfers significantly enhance regional economic performance.

Despite these positive findings, the empirical literature also reveals substantial variation in decentralization outcomes across regions. Several studies report that fiscal decentralization does not automatically lead to higher economic growth. Swasono (2015) provides evidence that decentralization, measured through own-source revenue and expenditure ratios, negatively affects regional growth when local fiscal capacity and institutional quality are weak. Khamdana (2016) similarly finds that fiscal decentralization does not significantly stimulate provincial economic growth during the 2008–2012 period, suggesting that structural constraints and governance limitations reduce policy effectiveness. These mixed results indicate that decentralization is a conditional process rather than a uniform growth-enhancing policy.

Regional inequality remains a persistent challenge within Indonesia's decentralized system. While decentralization was designed to reduce development gaps, empirical evidence suggests uneven outcomes. Suwanan and Sulistiani (2015) show that revenue decentralization is associated with lower regional disparities, implying that decentralization does not necessarily disadvantage poorer regions. However, Mursalin and Irawan (2025) document persistent income inequality across districts, even after accounting for fiscal transfers. Their findings underscore that profit-sharing funds play a critical role in shaping regional growth patterns, but they are insufficient to eliminate structural disparities without complementary local policies.

The role of intergovernmental transfers has received particular attention in the literature. Studies by Pujiati (2008) and Azis et al. (2022) reveal that revenue-sharing funds and regional own-source revenue exert a positive influence on regional economic growth, while general allocation funds often show insignificant or negative effects. This pattern suggests that unconditional transfers may weaken fiscal discipline and reduce incentives for local revenue mobilization. Ritonga and Hamzah (2021) further confirm that expenditure-based indicators of decentralization tend to promote growth, whereas revenue-based indicators may have adverse effects if local governments fail to diversify non-tax revenue sources.

Fiscal capacity and financial performance at the local level also shape decentralization outcomes. Priyarsono et al. (2010) find that intergovernmental transfers positively influence regional tax effort and economic growth, but they also highlight the low contribution of local revenue and high dependency on central funding. Kusuma and Anwar (2024) reinforce this view by showing that fiscal dependency coexists with economic growth in Central Java, indicating a complex relationship between autonomy and reliance. Nusi et al. (2025) demonstrate that regions with a higher degree of fiscal decentralization, reflected in stronger own-source revenue performance, are more likely to achieve sustained economic growth.

Recent studies extend the analysis by linking fiscal decentralization to inclusive development and poverty dynamics. Nazikha and Rahmawati (2021) provide evidence that decentralization positively influences inclusive growth by improving governance and public service delivery. Sakti et al. (2024) emphasize that robust fiscal capacity and effective local financial management contribute to convergence in inclusive economic development across provinces. Conversely, Dwiyanti et al. (2025) highlight that in

underdeveloped regions, weak governance, poor budget planning, and geographic constraints limit the growth impact of fiscal transfers, despite increased decentralization efforts.

Taken together, the existing literature suggests that fiscal decentralization in Indonesia has the potential to promote regional economic growth, but its effectiveness depends on fiscal structure, local capacity, and governance quality. While numerous empirical studies examine specific regions, periods, or fiscal components, a comprehensive synthesis at the district level remains limited. This study addresses this gap by systematically integrating empirical evidence on fiscal decentralization and regional economic growth in Indonesian districts. The objective is to clarify the conditions under which decentralization supports sustainable economic growth and to provide policy-relevant insights for strengthening local fiscal autonomy without increasing regional disparities.

Methods

Research Design

This study adopts a qualitative empirical synthesis design based on a systematic review of existing quantitative research on fiscal decentralization and regional economic growth in Indonesia. The design aims to integrate and critically evaluate empirical findings without generating new statistical estimations. This approach is appropriate given the extensive body of panel data–based studies examining decentralization outcomes at the district and provincial levels. The research framework remains aligned with fiscal decentralization theory and empirical growth analysis as applied in prior Indonesian studies (Tirtosuharto, 2010; Sasana, 2019).

Scope and Unit of Analysis

The unit of analysis in this study is the district and city level in Indonesia. The scope covers empirical studies that analyze fiscal decentralization outcomes across regions, including Java and non-Java provinces. The temporal coverage follows the periods examined in the reviewed studies, ranging from the early implementation of decentralization reforms to recent post-2020 evaluations. This scope ensures consistency with the decentralization regime and avoids methodological distortion caused by institutional changes across periods (Pujiati, 2008; Safitri, 2022).

Data Sources and Selection Criteria

The study relies exclusively on secondary data derived from peer-reviewed journal articles and academic dissertations listed in the article's reference section. All selected studies employ quantitative methods, primarily panel data regression, fixed-effects models, or dynamic panel estimations. Inclusion criteria are defined as follows: first, the study explicitly examines fiscal decentralization in Indonesia; second, the dependent variable is regional economic growth or a closely related indicator; third, the analysis is conducted at the district, city, or provincial level; and fourth, the study provides empirical results that allow comparison across regions or fiscal components. Studies that focus solely on descriptive analysis without empirical estimation are excluded.

Variables and Conceptual Framework

This study does not introduce new variables. It synthesizes empirical results using fiscal decentralization indicators consistently applied in prior research. These indicators include regional own-source revenue, revenue-sharing funds, general allocation funds, special allocation funds, and government expenditure. Regional economic growth is measured in the reviewed studies using gross regional domestic product growth or per capita growth indicators. The conceptual framework follows the decentralization-growth linkage established in Indonesian empirical literature, where fiscal autonomy and expenditure efficiency mediate growth outcomes (Subhan et al., 2024; Ritonga & Hamzah, 2021).

Analytical Procedure

The analysis proceeds in three stages. First, empirical findings from each selected study are systematically extracted, focusing on coefficient signs, statistical significance, and policy interpretation. Second, the results are grouped based on fiscal components and regional characteristics to identify convergence and divergence patterns. Third, the findings are interpreted using fiscal decentralization theory and contextualized within Indonesia's institutional framework. This comparative synthesis allows the study to assess whether decentralization effects are consistent, conditional, or contradictory across regions (Swasono, 2015; Mursalin & Irawan, 2025).

Validity and Reliability

To ensure analytical validity, the study strictly limits its scope to empirical evidence from recognized academic sources and avoids reinterpretation beyond the original findings. Reliability is strengthened through cross-study comparison and repetition of observed patterns across multiple regions and periods. By maintaining consistency in conceptual definitions and analytical logic, the study preserves the integrity of the original empirical results while enhancing their explanatory power (Priyarsono et al., 2010; Sakti et al., 2024).

Results and Discussion

Empirical Patterns of Fiscal Decentralization and Economic Growth

The empirical literature reviewed in this study shows a dominant pattern in which fiscal decentralization positively affects regional economic growth in Indonesia, particularly at the district and city levels. Studies using panel data methods consistently report that stronger regional own-source revenue and productive government expenditure contribute to higher growth rates (Sasana, 2019; Safitri, 2022; Subhan et al., 2024). These findings indicate that decentralization enhances growth when local governments possess sufficient fiscal autonomy to allocate resources efficiently.

However, the magnitude and direction of the impact differ across fiscal instruments. Revenue-based decentralization tends to generate stronger growth incentives when local governments actively expand their tax base and reduce transfer dependency. In contrast, regions with limited fiscal capacity experience weaker growth effects, even under decentralized arrangements (Swasono, 2015; Khamdana, 2016). This divergence confirms that decentralization outcomes are conditional rather than uniform.

Table 1. Summary of Empirical Findings on Fiscal Decentralization and Regional Growth in Indonesia

Author(s)	Level of Analysis	Fiscal Indicator	Impact on Growth	Key Interpretation
Sasana (2019)	District	Local expenditure, investment	Positive	Efficient spending drives growth
Subhan et al. (2024)	Regional	Fiscal autonomy, transfers	Positive	Autonomy strengthens performance
Swasono (2015)	Regional	Revenue ratio, expenditure ratio	Negative	Weak fiscal capacity limits impact
Azis et al. (2022)	District	DBH, DAK, PAD	Positive	Productive transfers support growth
Pujiati (2008)	District	DAU	Negative	Unconditional transfers weaken incentives
Ritonga & Hamzah (2021)	Province	Expenditure indicators	Positive	Spending decentralization matters

Mursalin & Irawan (2025)	District	DBH	Mixed	Growth with persistent inequality

Source: Synthesized from reviewed empirical studies.

This table highlights that decentralization effects depend strongly on fiscal structure. Transfers tied to performance or specific sectors show more consistent growth effects than unconditional grants.

Intergovernmental Transfers and Growth Incentives

A recurring empirical finding concerns the contrasting roles of intergovernmental transfers. Revenue-sharing funds and special allocation funds generally exhibit positive effects on regional economic growth, particularly when directed toward infrastructure and productive sectors (Azis et al., 2022; Zulkipli, 2018). These transfers support capital formation and regional competitiveness.

Conversely, general allocation funds frequently show insignificant or negative effects on growth. Pujiati (2008) and Ritonga and Hamzah (2021) argue that unconditional transfers reduce fiscal discipline and weaken local revenue mobilization efforts. This pattern suggests that decentralization without incentive-compatible transfer mechanisms may create dependency rather than growth.

Fiscal Capacity, Governance, and Regional Disparities

Empirical evidence indicates that fiscal capacity and governance quality play a critical mediating role. Regions with stronger financial management systems benefit more from decentralization reforms (Nusi et al., 2025; Sakti et al., 2024). Higher degrees of fiscal decentralization, reflected in stronger own-source revenue performance, are associated with sustained economic growth and improved financial resilience.

At the same time, decentralization does not automatically reduce regional inequality. Suwanan and Sulistiani (2015) show that revenue decentralization can lower disparities, yet Mursalin and Irawan (2025) document persistent income gaps across districts. Dwiyanti et al. (2025) further demonstrate that governance weaknesses in underdeveloped regions limit the growth impact of fiscal transfers, despite increased decentralization.

Theoretical and Policy Implications

The synthesized results are consistent with fiscal decentralization theory, which posits that growth gains depend on allocative efficiency and accountability (Tirtosuharto, 2010; Rustan, 1969). In Indonesia, decentralization promotes growth when local governments possess adequate fiscal capacity, manage expenditures efficiently, and face incentives to expand local revenue. Without these conditions, decentralization may reinforce dependency and uneven development.

These findings suggest that policy efforts should focus on strengthening local fiscal capacity, improving transfer design, and enhancing governance quality. Decentralization should be treated as a conditional growth mechanism rather than an automatic solution.

Conclusion

This study synthesizes empirical evidence on the relationship between fiscal decentralization and regional economic growth in Indonesian districts. The findings indicate that fiscal decentralization generally supports regional economic growth when local governments possess sufficient fiscal autonomy and allocate resources toward productive expenditures. Regional own-source revenue and performance-oriented intergovernmental transfers consistently show positive growth effects, reinforcing the role of fiscal capacity in driving local economic performance.

However, the impact of decentralization is not uniform across regions. Excessive reliance on unconditional transfers, particularly general allocation funds, weakens growth incentives and contributes

to fiscal dependency. Empirical evidence also demonstrates that governance quality and financial management capacity significantly mediate decentralization outcomes. Regions with stronger administrative capacity benefit more from decentralized fiscal authority, while areas with weak institutions experience limited growth gains despite increased transfers.

These findings confirm that fiscal decentralization in Indonesia operates as a conditional growth mechanism rather than an automatic driver of regional development. Policy implications emphasize the need to strengthen local revenue mobilization, improve expenditure efficiency, and redesign transfer mechanisms to enhance incentives for sustainable growth. Future research should focus on refining district-level evaluations and assessing institutional quality within existing decentralization frameworks to better understand regional variations in economic outcomes.

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