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The Effect Of Fiscal Decentralization On Regional Economic Growth

Andi Kurniawan[1], Fajar Rezeki Ananda Lubis[2], Syaifuddin[3]

[1,2,3]PUI Human Resources Management and Innovation Center, Universitas Prima Indonesia

Corresponding author : fajarrezekianandalubis@unprimdn.ac.id

Abstract

This study aims to analyze the impact of fiscal decentralization on regional economic growth in Indonesia. The method used is a literature approach by studying various sources. The research focuses on four things: (1) the basic concept of fiscal decentralization, (2) the impact of fiscal decentralization on regional economic growth, (3) factors influencing the effectiveness of fiscal decentralization, and (4) the relationship between fiscal decentralization and regional development strategies. Data sources were obtained from books, journals, government reports, and related policy documents. The research findings indicate that fiscal decentralization generally has a positive impact on regional economic growth, especially in regions with a high level of financial independence and a sound cash management system. Regions that are able to optimally collect local revenue can increase investment, create jobs, and strengthen productive sectors. However, this impact is not evenly distributed due to persistent disparities between regions, a lack of human resource capacity in the apparatus, and dependence on funds provided by the central government. Overall, fiscal decentralization is an important tool in strengthening regional economies, but its success depends heavily on financial management methods, institutional capabilities, and the commitment of local governments to managing public resources effectively and responsibly.

Keywords: Fiscal Decentralization, Regional Autonomy, Economic Growth, Fiscal Independence, Public Policy.

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INTRODUCTION

Economic development is a crucial goal for every country, aimed at improving the welfare of its people. One sign of successful economic development is continuous and equitable economic growth across all regions. One way the government addresses development disparities between regions is by implementing fiscal decentralization. Fiscal decentralization is part of the regional autonomy policy, which grants local governments the authority to independently manage and regulate state funds. This policy is regulated by Law Number 23 of 2014 concerning Regional Government and Law Number 33 of 2004 concerning Financial Balancing between the Central and Regional Governments. The goal is to provide regional financial independence, make resource management more efficient, and encourage economic growth in each region.

Within the framework of fiscal decentralization, the central government grants authority to regions in the form of fund transfers, such as the General Allocation Fund (DAU), the Special Allocation Fund (DAK), the Revenue Sharing Fund (DBH), and Regional Original Revenue (PAD) generated from regional taxes and levies. With this authority, it is hoped that regional governments will be able to finance development needs, improve infrastructure, enhance public services, and create an economic climate conducive to local economic growth. However, in its implementation, fiscal decentralization in Indonesia still faces various challenges. Some regions with high financial capacity show rapid economic growth, while regions with low financial capacity are actually lagging behind. This shows that the relationship between fiscal decentralization and regional economic growth is not always direct and can be influenced by various factors such as regional financial management methods, the capabilities of local leaders, the quality of the workforce, and the level of community involvement in development.

Furthermore, there is debate about the extent to which fiscal decentralization can stimulate economic growth. Some studies suggest that fiscal decentralization can improve the efficiency of resource use because local governments are more aware of local needs. However, others argue that decentralization can lead to new inequalities if not accompanied by sound institutional systems and management. In this regard, it is important to understand how fiscal decentralization policies in Indonesia actually affect economic growth at the regional level. From an economic development perspective, classical and modern theories offer different perspectives on the relationship between fiscal policy and economic growth. Classical theory, which focuses on the role of markets, tends to minimize government intervention. Meanwhile, Keynesian theory emphasizes

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the importance of the government's role in stimulating aggregate demand and economic growth. In the context of decentralization, the Keynesian approach supports an active role for local governments by increasing productive public spending to accelerate economic growth in their regions.

In the Indonesian context, since regional autonomy was implemented in 2001, fiscal decentralization has had a mixed impact. Some regions, such as East Java, West Java, and North Sumatra, have achieved significant economic growth, primarily due to increased local revenue (PAD) and more efficient budget management. Conversely, regions in the eastern region continue to lag behind, with slow economic growth and a heavy reliance on funds provided by the central government. This indicates differences in fiscal capacity and disparities in economic growth between regions, which require further investigation.

Fiscal decentralization also significantly impacts political and social aspects. On the one hand, decentralization can increase public engagement and make local governments more accountable, as policies and budgets are more closely aligned with citizens' needs. However, without adequate oversight, decentralization can create opportunities for corruption, misuse of funds, and misuse of regional resources. Therefore, improving the quality of economic growth through fiscal decentralization depends heavily on good governance, financial transparency, and the integrity of local officials.

From the perspective of Kurniadi (2020) research, this relationship was found to be insignificant in several provinces due to a lack of fiscal capacity and quality of budget management. Therefore, this research is important to better understand the relationship between fiscal decentralization and regional economic growth. The research findings are expected to assist governments, both central and regional, in formulating better policies to strengthen fiscal autonomy, improve financial management efficiency, and achieve national economic equality. Furthermore, this research is also expected to provide a new perspective on regional economic development in Indonesia, particularly with a focus on the quality of regional financial management and the level of regional independence as key factors driving inclusive and sustainable economic growth.

Based on the background description above, the research questions are as follows:

1. How is fiscal decentralization policy implemented in regions within the framework of regional autonomy in Indonesia?
2. How does fiscal decentralization affect regional economic growth in Indonesia?
3. What factors support and hinder the effectiveness of fiscal decentralization in

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driving regional economic growth?

4. What strategies do regional governments employ to optimize fiscal decentralization to promote sustainable economic growth?

LITERATURE REVIEW

Decentralization Theory

Decentralization, in general, is a way for the central government to grant authority to regional governments to manage and administer government affairs within a unitary state. According to Rondinelli (1981), decentralization is a process involving political, administrative, and financial aspects with the aim of increasing public participation and improving the quality of public services.

According to Rondinelli (1981), decentralization has four main types:

1. Deconcentration, which is the process of transferring power from the central government to officials in the regions.
2. Delegation, which is the assignment of authority to regional institutions to carry out certain tasks on behalf of the central government.
3. Devolution, which is the granting of complete political and administrative authority to regional governments.
4. Privatization, which is involving the private sector in carrying out tasks previously performed by the government.
5. According to Smith (1985), decentralization has three main aspects:
7. First, political decentralization, which is the granting of authority to regional political institutions such as the Regional People's Representative Council (DPRD) and regional leaders.
8. Second, administrative decentralization, which is the transfer of responsibility for carrying out government duties from the central government to the regions.
9. Third, fiscal decentralization, which is the granting of authority to manage incoming and outgoing government funds to regional governments.
10. Decentralization is expected to provide three important benefits:
    a. First, economic efficiency, because regional governments better understand the needs of their citizens.
    b. Second, social justice, by ensuring equitable development across all regions.
    c. Third, democratization, because the public can be more involved in deciding common affairs.

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In Indonesia, decentralization is implemented based on Law Number 23 of 2014 concerning Regional Government. This regulation states that regional governments have broad authority to administer and manage government affairs and the interests of local residents in accordance with applicable regulations. The goal of decentralization is to make government more efficient, the public more actively participate, and regional economic development can proceed more quickly. Decentralization is expected to ensure equitable distribution of development outcomes and strengthen democracy at the local level.

Fiscal Decentralization Theory

Fiscal decentralization is one concrete way to achieve decentralization, focusing on the management of financial resources. According to Oates (1972), in his theory of Fiscal Federalism, granting fiscal authority to regions can increase efficiency in providing public goods because local governments are more familiar with the desires and needs of their citizens.

According to Halim (2016), fiscal decentralization consists of three main elements:

a. Regional revenue — regions are given the right to collect taxes and levies according to their respective capabilities.
b. Fiscal transfers — the central government provides funds to regions in the form of General Allocation Funds, Special Allocation Funds, and Revenue Sharing Funds.
c. Regional expenditures — regions have the freedom to determine how much money will be spent according to their development needs.

In theory, fiscal decentralization helps promote more efficient use of public resources, strengthen regional financial independence, and stimulate local economic growth. However, its success depends heavily on the ability of local governments to manage their finances and their level of financial responsibility.

Musgrave (1959) explains three main functions of fiscal policy related to decentralization, namely:

a. Allocation function – determining the division of responsibility for providing public goods and services between the central and regional governments.
b. Distribution function – ensuring fairness and equitable distribution of income among regions.
c. Stabilization function – maintaining national economic stability while

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addressing regional interests.

Therefore, fiscal decentralization emphasizes the importance of balance between regional autonomy and central supervision to prevent inequality in financial management between regions.

Economic Growth Theory

The theory of economic growth explains the factors that influence the increase in national or regional production output over time.

a. Classical Theory (Adam Smith, David Ricardo, Thomas Malthus)Classical scholars viewed economic growth as the result of saving capital, increasing the labor force, and increasing productivity.
   Adam Smith, in his book, The Wealth of Nations (1776), emphasized the importance of the division of labor and free markets in driving economic growth.
b. Neoclassical Theory (Solow, 1956)
   Solow developed a growth model that emphasizes the role of physical capital, labor, and technological progress.
   In the long run, economic growth is determined by technological progress originating from outside the model.
c. Endogenous Growth Theory (Romer, 1990; Lucas et al., 1988)
   In contrast to neoclassical theory, this theory states that economic growth can occur internally, through efforts such as investing in education, innovation, and technology.
   Local governments can accelerate economic growth by implementing fiscal policies that encourage innovation and human resource development.
d. Regional Growth Theory (Myrdal, 1957; Hirschman, 1958)
   Myrdal, in his book, Theory of Cumulative Causation, explains that economic growth across regions is uneven, usually occurring more rapidly in developed regions.
   Therefore, decentralization of fiscal power is an important way to reduce inequality between regions through the redistribution of fiscal revenues.

The Theory of the Relationship between Fiscal Decentralization and Economic Growth

Based on the theory of Fiscal Federalism (Oates, 1972), fiscal decentralization can encourage economic growth in several ways:

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1. First, efficiency in resource management.
   Regions can adjust their use of funds and spending policies according to the needs of their local communities, preventing waste.
2. Second, increasing regional government accountability.
   With greater financial authority, regional governments must be more honest and accountable to the public.
3. Third, improving the quality of public services.
   Regions strive to provide the best services to gain political support and public trust.
4. Fourth, encouraging competition between regions.
   Each region competes to create the best investment environment and public services, which ultimately contributes to economic growth.

However, Oates also explained that there is a trade-off between fiscal autonomy and fiscal inequality. Regions with strong economies will develop faster, while less well-off regions may be left behind without assistance from the central government.

Public Finance Theory and Regional Autonomy

In public finance theory, the management of state funds must ensure efficiency, fairness, and economic stability. Fiscal decentralization is one way to apply this theory at the regional level.

According to Halim (2016), strong fiscal autonomy will have four main impacts:

1. First, improving regional capacity to provide services to the public.
2. Second, encouraging regions to innovate in finding revenue sources.
3. Third, reducing regional dependence on the central government.
4. Fourth, accelerating equality in economic development across regions.

However, in practice, fiscal autonomy often faces challenges such as disparities in financial capacity, corruption, and a lack of expertise. Therefore, oversight and a public accountability system are crucial for fiscal decentralization to run smoothly.

The Theory of Fiscal Inequality and Economic Justice

Fiscal imbalance occurs when a region's financial capacity is insufficient to meet its spending needs. In the Fiscal Federalism system, this problem is referred to as vertical imbalance, which is the gap between the central and regional governments, and horizontal imbalance, which is the difference in financial capacity between regions.
To overcome this, the central government provides fiscal transfers in the form of :

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- General Allocation Fund (DAU), which aims to equalize regional financial capacity.
- Special Allocation Fund (DAK), which is used for specific development purposes.
- Revenue Sharing Fund (DBH), which contains a portion of revenue from natural resources.

In theory, the effectiveness of fiscal transfers depends on how the funds are used to build infrastructure, improve education, and improve public services that can encourage local economic growth.

Theory of Good Governance and Fiscal Accountability

Fiscal decentralization will not work well if it is not based on the principles of good governance.

According to the UNDP (1997), good governance has three important principles:

1. First, transparency, meaning the process of managing regional funds must be open and clear to everyone.
2. Second, participation, meaning the public must be involved in planning and monitoring budget use.
3. Third, accountability, meaning regional governments must be responsible for the fiscal policies they adopt.

By implementing these three principles, public funds can be used efficiently, effectively, and produce tangible results for regional economic growth.

Relevance of Theory to Research

From the various theories explained previously, it can be concluded that:

a. Fiscal decentralization provides opportunities for regions to develop by managing their finances independently.
b. Regional economic growth is greatly influenced by the ability of local governments to manage finances efficiently, accountably, and possess strong institutional capacity.
c. Fiscal policy support from the central government remains necessary to minimize disparities between regions and ensure equitable national development.

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This study qualitatively describes how these theoretical relationships manifest themselves in the context of regional development in Indonesia after decentralization.

Previous Research and Empirical Supporting Theories

Previous research is crucial for understanding how fiscal decentralization affects regional economic growth, both in Indonesia and other countries. This research shows that outcomes vary depending on the institutional conditions, financial capacity, and public financial management practices of each region.

a. Paramitha & Ihalauw (2018)
   The study, "Fiscal Decentralization and Economic Growth in Indonesia," analyzed data from 33 provinces over 10 years. The results show that fiscal decentralization has a positive impact on economic growth, particularly through regional capital expenditure. However, this impact is greater in regions with high Regional Original Income (PAD). This means that fiscal independence is a critical factor in determining the success of decentralization.
b. Kurniadi (2020)
   The study, "Analysis of the Effects of Fiscal Decentralization on Inter- Regional Economic Growth Inequality," found that fiscal decentralization actually widens economic inequality between provinces. This is due to differences in regional economic potential and high fiscal dependence on the central government. This finding underscores the importance of monitoring fund transfers to prevent moral hazard at the regional level.
c. Halim (2022)
   This study examines regional financial management methods. The results indicate that a decentralized financial system will function effectively if supported by transparency, community involvement, and accountability in budget preparation. Regions with participatory financial planning processes tend to experience better economic growth.
d. Rachmawati and syafariuddin (2022)
   In his thesis “Fiscal Independence and Regional Economic Growth in Eastern Indonesia”, the researcher found that although these regions received large fiscal transfers, their impact on economic growth was not optimal due to the still weak bureaucratic capacity and low productivity of public spending.
e. Davoodi dan Zou (1998)

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Through research on 46 developing countries, they found that the level of financial decentralization has a positive impact on economic growth in countries with good governance. However, in countries with high levels of corruption, the impact is negative.

f. Martinez-Vazquez dan McNab (2003)
This research shows that the relationship between fiscal decentralization and economic growth is not a straightforward one. Initially, decentralization can help increase efficiency and economic growth; however, if not accompanied by strengthening financial institutions, it can lead to inequality and inefficiency in financial management.

g. Rodden (2004)
In analyzing various European countries, Rodden concluded that fiscal decentralization can improve the quality of public services and strengthen regional financial stability as long as there is an effective vertical fiscal oversight mechanism between the central government and regional governments.

h. Thießen (2003)
In developed countries, fiscal decentralization has a positive impact on policy innovation and economic growth because local governments have good administrative capabilities and are supported by transparency in budget management.

Based on previous theories and research results, there are four main ways to explain the relationship between fiscal decentralization and regional economic growth:

a. Efficient Allocation Mechanism (Fiscal Efficiency)
Because regions are more familiar with the needs and expectations of local communities, fund allocation is more precise and efficient than if decisions were made by the central government (Oates, 1972).

b. Incentive Mechanism (Incentive Mechanism)
Fiscal decentralization motivates local governments to increase regional revenue (PAD) by innovating in policies and providing public services (Tiebout, 1956).

c. Redistribution Mechanism (Redistribution Mechanism)
The central government provides funds to less developed regions to reduce inter-regional inequality and ensure equitable economic growth (Musgrave, 1959).

d. Institutional Development Mechanism (Institutional Development)

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Fiscal decentralization helps strengthen local government capacity, increase transparency in the use of funds, and encourage economic change by improving the quality of public services (Romer, 1990).

Relevance of Theory to Research

From the various theories discussed previously, it can be concluded that:

a. Fiscal decentralization provides opportunities for regions to develop by managing their finances independently.
b. Regional economic growth is highly dependent on the efficiency, accountability, and capacity of local government institutions.
c. Fiscal policy support from the central government remains necessary to minimize disparities between regions and ensure equitable national development.

This research qualitatively analyzes how these theoretical relationships manifest in the context of regional development in Indonesia after decentralization.

RESEARCH METHOD

Research Approaches and Types

This research uses a literature-based approach. This approach was chosen because the research aims to understand, describe, and analyze in depth the concepts, theories, and results of previous research regarding the impact of fiscal decentralization on regional economic growth. According to Creswell & Creswell, (2017), qualitative research aims to explore the meanings associated with individuals or groups regarding a social phenomenon. This approach is suitable for a deeper understanding of how the implementation of fiscal decentralization in Indonesia affects regional economic growth, through the analysis of documents, regulations, and previous research results. In other words, this research does not focus on testing hypotheses using statistical methods, but rather on a deeper understanding of the relationship between fiscal policy and economic growth at the regional level based on existing theories and research results.

Research Location and Focus

This study discusses the situation of fiscal decentralization in Indonesia after regional autonomy was implemented based on Law Number 23 of 2014 concerning Regional Government and Law Number 33 of 2004 concerning Financial Balance between the Central and Regional Governments.

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This research focuses on several key issues, namely:

- First, fiscal decentralization policies, which encompass how regions manage their revenues, central government funds, and the use of regional spending.
- Second, the impact of these fiscal policies on regional economic growth, particularly through indicators such as Gross Regional Domestic Product (GRDP), investment levels, and infrastructure development.
- Third, factors that facilitate and hinder the effectiveness of fiscal decentralization in accelerating regional economic growth.

Data Types and Sources

This research uses secondary data obtained from various relevant and reliable reference book sources. The secondary data used includes :

Legal and regulatory sources, such as:

1. Law Number 23 of 2014 concerning Regional Government.
2. Law Number 33 of 2004 concerning Fiscal Balance between the Central and Regional Governments.
3. Regulations from the Minister of Finance and other implementing regulations.
4. Academic sources, including:
5. Books on public economic theory, development economics, and fiscal decentralization.
6. National and international scientific journals discussing the topics of decentralization and economic growth.
7. Previous research results, dissertations, and theses.
8. Data sources from institutions, such as:
9. Data from the Central Statistics Agency (BPS) regarding GRDP and regional fiscal structure.
10. Reports from the Ministry of Finance and the Ministry of Home Affairs regarding the implementation of fiscal transfers to regions.
11. Annual reports from regional governments.

Data collection technique

Because this research uses a qualitative literature approach, data collection was carried out in three main stages (Greene, 2004):

1. First, source identification and inventory.
2. This stage involves collecting various reading materials such as books,

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journals, reports, and regulations related to the research topic.

3. Second, data classification and categorization.

The collected data is divided based on main themes, including:

- Decentralization and fiscal decentralization theory
- Factors influencing regional economic growth
- The relationship between fiscal policy and economic development
- Empirical studies conducted in Indonesia and other countries

4. Third, data reduction and synthesis.

Information from various sources is selected and re-explained into key concepts that answer the main research questions. Furthermore, the data is supported by official government documents and academic literature published between 2018 and 2024 to ensure the results remain relevant to current conditions.

RESULTS AND DISCUSSION

The Concept of Fiscal Decentralization within the Framework of Regional Autonomy

Fiscal decentralization is a crucial component of the implementation of regional autonomy in Indonesia. Its goal is to grant regions greater authority over their own money and financial resources, thereby improving public welfare.

According to Law Number 33 of 2004 concerning Fiscal Balance between the Central and Regional Governments, fiscal decentralization means transferring some financial management authority from the central government to the regions, allowing them to independently fund government affairs and public services. Based on the literature review, there are two main aspects of fiscal decentralization:

1) Revenue Decentralization – the ability of regions to collect revenues such as regional taxes and levies.
2) Expenditure Decentralization – the authority of regions to determine and use budgets according to regional development needs.

In general, public economic theory explains that fiscal decentralization can increase regional economic efficiency because local governments better understand the needs of local communities (Musgrave, 1959).

Thus, fiscal decentralization is not merely a fiscal policy, but also an instrument for economic equality and increased local government accountability to the public.

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The Relationship between Fiscal Decentralization and Regional Economic Growth

Several empirical studies have shown a positive relationship between fiscal decentralization and regional economic growth, but this relationship is not entirely conditional. Previous research has shown that increasing regional fiscal independence can support economic growth, particularly when supported by institutional capacity and sound financial management.

For example, a study by Adi (2016) found that regions with a high ratio of local revenue (PAD) tended to have better GRDP growth than regions that relied heavily on transfers from the central government. However, other results also indicate that financial decentralization does not automatically drive economic growth. In Indonesia, inter-regional inequality and limited resources remain major problems. According to research by Malinowski & Smoluk-Sikorska, (2020), regions with low financial capacity tend to experience slow economic growth due to difficulties in effectively using allocated funds. Therefore, the ability of financial decentralization to drive economic growth depends heavily on several factors, namely:

1. Regional financial independence (level of local revenue),
2. Efficient use of government spending,
3. Transparency and accountability in regional financial management.

Factors Influencing the Effectiveness of Fiscal Decentralization

Research shows that there are several things that support and hinder the success of fiscal decentralization in encouraging regional economic growth.

a. Supporting Factors

1) Regional Financial Capacity
   Regions with high regional revenue (PAD) have greater ability to determine the focus of economic development and investment.
2) Quality of Regional Employees
   Professional and honest regional employees are able to manage funds effectively and efficiently.
3) Infrastructure and Economic Potential
   The existence of adequate infrastructure and local economic potential such as agriculture, industry, or tourism enhance the benefits of fiscal decentralization for economic development.
4) Transparency and Public Involvement

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Transparency in budget preparation and implementation increases public trust and ensures the proper use of funds.

b. Inhibiting Factors

1) Differences in Financial Wealth Between Regions
Many regions remain highly dependent on funds provided by the central government, especially underdeveloped regions.

2) Low Quality of Regional Financial Management
Problems in planning, corruption, and wasteful budget use reduce the results of regional financial policies.

3) Limited Human Resources and Administrative Systems
Regions with weak bureaucracies are often unable to maximize their financial potential.

4) Uneven Distribution of Investment
Investment tends to be concentrated in developed regions, thus widening economic disparities between regions.

The Impact of Fiscal Decentralization on Regional Economic Growth

In general, research results indicate that fiscal decentralization helps boost regional economic growth, primarily through three key factors: increasing government investment, developing local economic sectors, and improving the efficiency of regional financial management. However, the benefits of this decentralization have not been evenly distributed across Indonesia. According to Statistics Indonesia (BPS) data, most economic growth is still dominated by resource-rich regions, such as Java, Sumatra, and Kalimantan. Meanwhile, regions in eastern Indonesia, such as East Nusa Tenggara (NTT), Maluku, and Papua, remain dependent on balanced funds and experience lower economic growth. This finding aligns with the theory of Fiscal Federalism (Oates, 1972), which states that fiscal decentralization is only effective if supported by equitable resource distribution and efficient governance systems at the regional level.

DISCUSSION

Basic Concepts and Principles of Fiscal Decentralization within the Framework of Regional Autonomy

Fiscal decentralization is a key component of regional autonomy, granting local governments greater authority to manage their finances independently. The goal is to enable regions to more effectively manage financial resources according to local needs.

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According to Musgrave (1959), fiscal decentralization is a way of dividing financial responsibilities between the central and regional governments.

The goal is to increase efficiency and make economic development more equitable. Oates (1972) added that delegating fiscal authority to regions would be more effective because local governments would be more aware of the conditions and needs of the communities in their areas.

In Indonesia, fiscal decentralization is regulated by several laws, namely:

1. Law Number 33 of 2004 concerning Fiscal Balance between the Central Government and Regional Governments,
2. Law Number 23 of 2014 concerning Regional Government. Some of the basic principles of fiscal decentralization are:
    a. Fiscal Independence – regions have the right to manage their own revenues and expenditures.
    b. Justice and Equity – fiscal policy should help reduce disparities between regions.
    c. Economic Efficiency – the use of regional funds is directed towards increasing productivity and community welfare.

Accountability – all budget expenditures must be honest and subject to public scrutiny.

By applying these principles, fiscal decentralization is expected to improve the quality of public services and strengthen the local economy in a sustainable manner.

The Impact of Fiscal Decentralization on Regional Economic Growth

The relationship between fiscal decentralization and regional economic growth is frequently discussed by researchers. In general, fiscal decentralization can have a positive impact on economic growth, but its effectiveness depends on the region's ability to manage its finances and resources. According to Ginanjar et al. (2025), the higher the level of fiscal independence of a region, as evidenced by the increase in Regional Original Income (PAD), the greater the region's contribution to Gross Regional Domestic Product (GRDP). Regions with higher PAD can invest more in areas such as infrastructure, education, and public services, ultimately driving economic growth.

However, other research, such as that of Saptono et al. (2025), states that the benefits of fiscal decentralization are not the same across all regions. Regions with abundant resources or strong economies, such as West Java, East Java, and East

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Kalimantan, experienced better economic growth than regions with lower fiscal capacity, such as NTT and Papua.

Factors Influencing the Effectiveness of Fiscal Decentralization on Regional Economic Growth

The effectiveness of fiscal decentralization in driving economic growth is influenced by various interrelated factors. Based on previous research and literature reviews, these factors can be divided into two main groups: supporting factors and inhibiting factors.

a. Supporting Factors
   1) Regional Fiscal Independence (PAD)
      A high PAD demonstrates a region's independence and ability to leverage local economic potential. With a strong PAD, regions can fund development without over-reliance on central government funding.
   2) Human Resources (HR) Capacity
      Regional government apparatus with quality and integrity can design fiscal policies that are on target and improve budget management efficiently.
   3) Quality of Good Governance
      Transparency, accountability, and community involvement in the preparation of the Regional Revenue and Expenditure Budget Plan (APBD) strengthen the effectiveness of fiscal decentralization.

b) Inhibiting Factors
   1) Fiscal Inequality Between Regions
      Dependence on central transfer funds such as the General Allocation Fund (DAU) and Special Allocation Fund (DAK) indicates weak fiscal independence.
   2) Unproductive Regional Spending
      Many regions still focus on routine spending (employee salaries, operational costs) rather than productive capital expenditures such as infrastructure and education.
   3) Low Quality of Budget Planning and Oversight
      Weak planning results in fiscal policies not being aligned with regional development priorities.
   4) Corruption and Bureaucratic Inefficiency

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Financial irregularities hinder the effectiveness of fiscal decentralization policies in boosting economic growth.

5) Limited Institutional Capacity
Weak internal administration and oversight systems lead to fiscal leakage and low public accountability.

These factors show that the success of fiscal decentralization depends not only on the amount of funds that regions have, but also on how these funds are managed and allocated to productive activities.

The Relevance of Fiscal Decentralization to the Development of Regional Economic Development Strategies in Indonesia

Fiscal decentralization is very important for developing regional economies, because it helps :

1. Reducing dependence on the central government,
2. Equipping development across regions, and
3. Managing public resources more efficiently.

In an effort to develop regional economies, fiscal decentralization allows local governments to create policies tailored to local socio-economic conditions. For example, agricultural-based regions can focus on irrigation development and agricultural technology, while industrial-based regions can develop industrial estates and logistics transportation systems.

Khusaini et al. (2018) research showed that well-managed fiscal decentralization can increase domestic investment, create jobs, and encourage more equitable and inclusive economic growth. Furthermore, this policy is crucial because it can promote good governance and enhance the role of communities in formulating regional development plans. However, for fiscal decentralization to be truly beneficial and aligned with national development goals, the following factors are necessary:

1. First, there needs to be a reform of fiscal transfer policies by adjusting the method of disbursing funds to regions to make them more equitable and based on regional performance.
2. Second, improve regional financial management capabilities by maximizing regional original revenue (PAD) and strengthening the local economy.
3. Third, integrate fiscal policy with development planning to align financial policies with the Sustainable Development Goals (SDGs).

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4. Fourth, utilize digital technology to increase transparency, efficiency, and accountability in regional financial management.

Thus, fiscal decentralization is not only a tool for financial management but also a crucial strategy for realizing independent, inclusive, and sustainable regional economic development.

CONCLUSION

This research shows that fiscal decentralization helps boost regional economic growth, especially when supported by financial independence, sound management, and effective budget utilization. Fiscal decentralization allows regions to manage their finances independently, adapt development policies to local potential, and improve the efficiency and quality of public services. However, the benefits are not uniform across Indonesia due to persistent financial inequality, lack of institutional capacity, and high dependence on central government funding. Factors determining the success of fiscal decentralization include regional revenue, the quality of the government workforce, transparency in budget management, and the region's ability to manage public funds efficiently. Overall, fiscal decentralization is crucial for regional economic growth and needs to be complemented by capacity building, local policy innovation, and strong cooperation between the central and regional governments to ensure sustainable and equitable economic growth.

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