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# The Influence of Regional Original Income and Balancing Funds on Economic Growth through Regional Expenditure in Central Java Province

**Ade Mulya Pratomo[1*], Gregorius Nasiansenus Masdjojo[2]**
[1,2] Master of Management, Stikubank University Semarang, Indonesia

** Corresponding Author: ademulya7010@mhs.unisbank.ac.id*

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ABSTRACT

*This study aims to examine the effect of Regional Original Revenue (Pendapatan Asli Daerah—PAD) and Fiscal Balance Funds on Economic Growth, with Regional Expenditure serving as a mediating variable in regencies and municipalities of Central Java Province during the 2021–2025 period. This study employed a quantitative approach with a causal associative research design using secondary panel data obtained from the Regional Revenue and Expenditure Budget (APBD) of 35 regencies and municipalities in Central Java Province. The data were analyzed using panel data regression with the Fixed Effect Model (FEM) and corrected using White Diagonal Standard Errors to address heteroskedasticity. The findings reveal that Regional Original Revenue has no significant effect on Regional Expenditure or Economic Growth. Conversely, Fiscal Balance Funds have a positive and significant effect on both Regional Expenditure and Economic Growth. In addition, Regional Expenditure has no significant effect on Economic Growth and is unable to mediate the relationship between Regional Original Revenue, Fiscal Balance Funds, and Economic Growth. These findings indicate that Fiscal Balance Funds remain the primary source of regional financing in supporting regional development and economic growth, while the contribution of Regional Original Revenue has not yet provided a significant direct impact.*

## INTRODUCTION

Economic growth is one of the main indicators reflecting the success of a region's development. Economic growth demonstrates a sustainable increase in production capacity and community income, thereby improving community welfare (Todaro & Smith, 2012). In a regional context, economic growth is measured by the growth rate of Gross Regional Domestic Product (GRDP) at constant prices, which reflects changes in real output over time (BPS Central Java Province, 2025). Therefore, economic growth is an important benchmark in evaluating the effectiveness of regional development policies.

Empirically, the economy of Central Java Province exhibited fluctuating developments during the 2020–2024 period. Based on data from the Central Java Provincial Statistics Agency (2025), economic growth contracted by 2.65% in 2020 due to the impact of the COVID-19 pandemic. This condition then gradually improved with growth of 3.33% in 2021, increasing to 5.31% in 2022, and reaching around 4.95% in 2024. This development indicates that the regional economic recovery process is ongoing and requires the support of effective regional fiscal policies to maintain sustainable economic growth.

The implementation of regional autonomy grants broader authority to local governments in managing regional resources and finances through fiscal decentralization mechanisms. This policy is expected to increase regional fiscal independence, enabling local governments to plan and implement development according to the characteristics and needs of their regions (Latifah & Rahayu, 2019). According to (Oates, 1999), fiscal decentralization enables local governments to provide more responsive public services because development decisions are made closer to the community. In supporting the implementation of regional autonomy, the government's fiscal capacity is greatly influenced by the optimization of regional revenue sources, particularly Regional Original Revenue (PAD) and the Balancing Fund.

Regional Original Income (PAD) is an important indicator that reflects the level of fiscal independence of a region because it originates from the region's economic potential, such as regional taxes, regional levies, the results of managing separated regional assets, and other legitimate regional original income (Hasanah et al., 2025). On the other hand, the Balancing Fund, consisting of the General Allocation Fund (DAU), the Special Allocation Fund (DAK), and the Revenue Sharing Fund (DBH), is a central government transfer instrument aimed at reducing fiscal inequality between regions while supporting the implementation of fiscal decentralization (Latifah & Rahayu, 2019). The synergy between PAD and the Balancing Fund is expected to increase the fiscal capacity of regional governments in financing development through Regional Expenditures, thereby encouraging economic growth. In line with this, Ariyanto and Masdjojo (2025) found that capital expenditure can be a link between PAD and the Balancing Fund components in the form of DAU and DAK by increasing regional financial independence through the utilization of regional infrastructure and assets.

Based on data from the Central Java Provincial Budget (APBD), the structure of Regional Original Revenue (PAD) over the past five years has been above 50% and shows a continuing upward trend. Meanwhile, the Balancing Fund has indeed experienced a downward trend, but still contributed 36.06% to total regional revenue in 2025. This condition indicates that despite increasing levels of regional fiscal independence, regional governments still have a significant dependence on transfer funds from the central government. This phenomenon raises questions about the extent to which PAD and the Balancing Fund are able to drive regional economic growth directly or through Regional Expenditure as the main instrument of fiscal policy.

Conceptually, regional revenues sourced from PAD and the Balancing Fund will be allocated through Regional Expenditures to finance government administration, infrastructure development, public service provision, and various economic development programs. Effective expenditure allocation is expected to create economic stability, increase community productivity, and encourage regional economic growth (Ambya, 2023). Empirical findings by Isnowati et al. (2023) also indicate that government spending has a positive effect on economic growth in districts/cities in Central Java Province. Thus, Regional Expenditures are suspected to have a strategic role as a mechanism linking local government fiscal capacity with increased economic activity.

However, previous research results still show inconsistencies. Rizqullah & Meldona, (2023) found that Regional Original Revenue had no effect on Regional Expenditure, in line with the findings of Akuarista & Masdjojo (2015) who concluded that Regional Expenditure had no effect on Regional Original Revenue. Research by Rizqullah & Meldona, (2023) also showed that the General Allocation Fund as part of the Balancing Fund had no effect on Regional Expenditure. This finding is supported by Sumarni et al. (2024)) who stated that the General Allocation Fund and Special Allocation Fund had no significant effect on Regional Expenditure, although the Revenue Sharing Fund had a significant effect.

Inconsistencies in research results were also found in the relationship between regional fiscal capacity and economic growth. Pangestu et al. (2023) concluded that Regional Original Income had no significant effect on Economic Growth, while Parengkuan & Rahman (2024) found that Regional Original Income had a negative and insignificant effect on Economic Growth. Meanwhile, Hermansyah et al. (2024) stated that the Balancing Fund mediated by Regional Expenditure has not been able to significantly increase economic activity and community welfare. These results are supported by research by Rizqullah & Meldona (2023) which shows that Regional Expenditure is unable to mediate the influence of Regional Original Income or General Allocation Fund on Economic Growth.

These differences in empirical findings indicate that the relationship between Regional Original Revenue, Balancing Funds, Regional Expenditures, and Economic Growth still requires further study. In addition to the inconsistencies in research findings, most previous studies only tested the direct relationship between variables or used different regions and observation periods. Therefore, this study offers a novelty by analyzing the role of Regional Expenditures as a mediating variable in the relationship between Regional Original Revenue and Balancing Funds on Economic Growth using panel data from 35 regencies/cities in Central Java Province during the 2021–2025 period. This approach is expected to provide a more comprehensive empirical picture of the effectiveness of regional financial management in driving economic growth in the post-pandemic recovery era.

Based on the above description, this study aims to analyze the influence of Regional Original Revenue and Balancing Funds on Economic Growth, with Regional Expenditure as a mediating variable, in districts/cities in Central Java Province for the 2021–2025 period. The research findings are expected to enrich the literature on fiscal decentralization and regional development economics and provide input for local governments in formulating more effective financial management policies to support sustainable economic growth.

## RESEARCH METHODS

This study uses a quantitative approach with a causal associative approach to analyze the relationship between Regional Original Income (PAD), Balancing Funds, Regional Expenditures, and Economic Growth. The data used are secondary data sourced from the Regional Revenue and Expenditure Budget (APBD) and publications from the Central Java Provincial Statistics Agency (BPS). The data are compiled in panel data format, combining *cross-sectional* and *time series dimensions*, covering 35 regencies/cities in Central Java Province during the 2021–2025 period, resulting in 175 observation units.

The study population included all 35 district/city governments in Central Java Province. This study used a saturated sampling technique (census), so all members of the population were used as samples. Using the entire population was intended to obtain a more comprehensive picture of the relationships between variables in local governments in Central Java Province.

The dependent variable in this study is Economic Growth, measured using the growth rate of Gross Regional Domestic Product (GRDP) at constant prices. The independent variables consist of Regional Original Income (PAD) and Balancing Funds, while Regional Expenditure acts as a mediating variable. Data were analyzed using panel data regression with the help of EViews software. Regression model selection was carried out through the Chow test, the Hausman test, and the Lagrange Multiplier test to determine the most appropriate estimation model. Based on the test results, the best model used was the Fixed Effect Model (FEM). Furthermore, to address heteroscedasticity symptoms, estimation was carried out using White Diagonal Standard Errors to produce a robust estimator.

**Table 1.** Operational Definition of Variables

| Variables | Indicator | Scale | Data source |
|---|---|---|---|
| Locally-generated revenue | PAD Value (Rp) | Ratio | Regional Budget |
| Balancing Fund | General Allocation Fund + Special Allocation Fund + Revenue Sharing Fund (Rp) | Ratio | Regional Budget |
| Regional Shopping | Total Regional Expenditure (Rp) | Ratio | Regional Budget |

| | | | |
|---|---|---|---|
| Economic growth | ADHK GRDP Growth (%) | Ratio | Central Java Province Statistics Agency |

Source: Processed by researchers based on Law No. 1 of 2022 and BPS Central Java Province 2025.

Hypothesis testing is carried out through a partial test ( *t-test* ) to determine the influence of each independent variable on the dependent variable, a simultaneous test ( *F-test* ) to test the influence of the independent variables together, and a coefficient of determination ( *Adjusted* $R^2$ ) to measure the model's ability to explain variations in the dependent variable.

The Sobel Test was used to test the mediation effect of Regional Expenditure to test the significance of the indirect effect of Regional Original Income and Balancing Funds on Economic Growth through Regional Expenditure. This test was conducted by comparing the test statistic value ( *Z-value* ) to the critical value at a significance level of 5%. The mediating variable is declared to play a role if the probability value ( *p-value* ) is less than 0.05 or the Z-value is greater than 1.96. Conversely, if the probability value is greater than 0.05 or the Z-value is less than 1.96, then Regional Expenditure is declared unable to mediate the relationship between the independent and dependent variables.

## RESULTS AND DISCUSSION

### The Influence of Regional Original Income and Balancing Funds on Regional Expenditures

The regression estimation results show that Regional Original Revenue (PAD) has no significant effect on Regional Expenditure, while the Balancing Fund has a positive and significant effect on Regional Expenditure in regencies/cities in Central Java Province during the 2021–2025 period. This finding indicates that increased fiscal capacity derived from PAD has not been a primary factor in determining the amount of regional government expenditure. Conversely, fiscal transfers from the central government remain the dominant source of financing in the preparation and implementation of the Regional Revenue and Expenditure Budget (APBD).

The insignificant effect of PAD indicates that increased regional revenue has not automatically been followed by increased regional government spending. This condition indicates that fiscal capacity across regions in Central Java Province is still relatively uneven, with regions with a strong economic base able to generate higher PAD than regions still dominated by the primary sector. Consequently, the contribution of PAD to the overall APBD structure is not yet large enough to influence regional spending patterns in aggregate. This finding is in line with the *Fiscal Federalism theory* proposed by Oates (1999) , which explains that in regions with unequal fiscal capacity, the central government still plays a crucial role through intergovernmental transfer mechanisms to ensure the provision of public services and reduce fiscal inequality.

The results of this study differ from those of Rizqullah & Meldona (2023) , Parengkuan and Rahman & Sumarni (2024) , and Pangestu et al. (2023) , who concluded that PAD influences regional expenditure. This difference is thought to be influenced by the fiscal characteristics of districts/cities in Central Java Province, which still show a high dependence on the Balancing Fund. Therefore, increasing PAD has not yet become the primary basis for determining regional government spending policies.

Conversely, the Balancing Fund has been shown to have a positive and significant impact on Regional Expenditures. These results indicate that increased fiscal transfers from the central government directly increase the capacity of regional governments to finance governance and development. This finding supports the concept of *Fiscal Federalism* , which positions the Balancing Fund as an instrument to address *the vertical fiscal imbalance* between the central and regional governments. Fiscal transfers enable regional governments to maintain the continuity of public services despite varying fiscal capacities.

This finding is consistent with research by Rizqullah & Meldona (2023) and Pangestu et al. (2023) , which states that the Balancing Fund is the primary determinant of Regional Expenditure. For districts/cities in Central Java Province, the Balancing Fund remains a relatively more stable source of funding than PAD, so local governments tend to use this transfer as the basis for preparing the Regional Budget (APBD). This condition indicates that although the implementation of fiscal decentralization has increased regional authority in financial management, dependence on central government transfers remains a key characteristic of regional fiscal management during the study period.

**The Influence of Regional Original Income, Balancing Funds, and Regional Expenditure on Economic Growth**

The regression estimation results show that Regional Original Income (PAD) has no significant effect on Economic Growth, while the Balancing Fund has a positive and significant effect. On the other hand, Regional Expenditure also proved to have no significant effect on Economic Growth in districts/cities in Central Java Province during the 2021–2025 period. These findings indicate that the increase in regional economic activity during the study period was more influenced by the capacity of fiscal transfers from the central government than by regional fiscal capacity or the amount of regional government spending.

The insignificant effect of PAD indicates that the increase in local revenue has not been able to directly drive economic growth. Although PAD reflects the level of fiscal independence of local governments, this increase in revenue has not been fully directed towards activities that can increase economic productivity. Furthermore, the contribution of PAD between districts/cities in Central Java Province still shows significant disparities, so that the increase in PAD is only concentrated in regions with relatively high economic activity. This condition causes the effect of PAD on aggregate economic growth to be insignificant. This finding is consistent with research by Pangestu et al. (2023) and Parengkuan & Rahman (2024) , which shows that PAD has not had a significant impact on regional economic growth. These results also indicate that increased regional revenue is not always followed by increased economic activity if not accompanied by productive fiscal management.

Conversely, the Balancing Fund has been shown to have a positive and significant impact on economic growth. This finding indicates that fiscal transfers from the central government remain a crucial instrument in driving regional economic activity. The Balancing Fund provides additional fiscal capacity, enabling regional governments to maintain the provision of public services, infrastructure development, and various regional development programs. From a *Fiscal Federalism perspective* , intergovernmental transfers serve to reduce fiscal imbalances while maintaining the sustainability of development in regions with limited fiscal capacity. This study corroborates the findings of Pangestu et al. (2023) that the Balancing Fund still plays a strategic role in supporting economic growth, particularly in regions that lack a high level of fiscal independence.

Unlike the Balancing Fund, Regional Expenditure has not been shown to have a significant impact on Economic Growth. This result indicates that the amount of regional government expenditure does not fully reflect the quality of spending capable of creating economic added value. Empirically, increased spending is not always followed by an increase in economic output if the budget allocation is still dominated by operational spending compared to productive spending, such as infrastructure development, human resource development, or support for regionally superior sectors. This finding is in line with research by Hermansyah et al. (2024) and Rizqullah & Meldona (2023) , which shows that the amount of Regional Expenditure is not necessarily able to drive economic growth if the effectiveness and quality of budget allocation are still low. Therefore, the results of this study confirm that the success of regional fiscal policy is not only determined by the amount of budget spent, but also by the ability of local governments to direct spending to programs that have a sustainable economic impact.

**The Role of Regional Expenditure in Mediating the Influence of Regional Original Income and Balancing Funds on Economic Growth**

The Sobel test results indicate that Regional Expenditure is unable to mediate the influence of Regional Original Income (PAD) or Balancing Funds on Economic Growth in districts/cities in Central Java Province during the 2021–2025 period. *The Sobel test statistic value* for the PAD–Regional Expenditure–Economic Growth path and the Balancing Fund–Regional Expenditure–Economic Growth path is smaller than the critical value of 1.96 with *a probability* above 0.05, so both mediation hypotheses are rejected. This finding indicates that the mechanism for increasing economic growth through Regional Expenditure has not been empirically established in the research model.

The lack of a mediating effect on the relationship between PAD and Economic Growth can be explained by the results of previous tests, which showed that PAD had no significant effect on Regional Expenditure, while Regional Expenditure also had no significant effect on

Economic Growth. With the insignificance of both pathways, the indirect effect of PAD through Regional Expenditure is very weak. These results indicate that increases in PAD have not been fully translated into spending policies capable of stimulating regional economic activity. This finding is in line with research by Rizqullah & Meldona (2023) , which states that Regional Expenditure is unable to carry out its mediating function when regional revenue is used more for meeting government operational needs than for productive spending.

Similar results were found in the relationship between the Balancing Fund and Economic Growth through Regional Expenditure. Although the Balancing Fund was proven to increase Regional Expenditure, the channel through which Regional Expenditure impacts Economic Growth was insignificant, resulting in an indirect effect. This indicates that the increase in fiscal capacity resulting from central government transfers has not been fully accompanied by spending allocations capable of generating direct economic impacts. In other words, the size of the budget disbursed by regional governments does not guarantee increased economic growth if the quality and effectiveness of spending remain suboptimal.

These findings reinforce the research findings of Hermansyah et al. (2024) and Rizqullah & Meldona (2023) , which show that regional expenditure has not yet been able to act as a transmission mechanism between regional fiscal capacity and economic growth. Conceptually, regional expenditure will function as a mediating variable if increased regional revenue is accompanied by budget allocations to productive sectors that can increase investment, productivity, and employment opportunities. However, the results of this study indicate that this function has not been functioning optimally in districts/cities in Central Java Province during the study period.

Overall, the research results indicate that the Balancing Fund remains the most consistent factor influencing Economic Growth, while PAD has not been able to increase economic growth either directly or through Regional Expenditure. This finding suggests that the main challenge in regional financial management lies not only in increasing fiscal capacity, but also in improving the quality of budget allocation. Therefore, regional governments need to direct Regional Expenditure more effectively towards productive programs so that regional revenues, both from PAD and the Balancing Fund, can have a greater impact on economic growth.

## CONCLUSION AND SUGGESTIONS

### Conclusion

This study aims to analyze the influence of Regional Original Revenue (PAD) and the Balancing Fund on Economic Growth, with Regional Expenditure as a mediating variable in regencies/cities in Central Java Province for the 2021–2025 period. The results show that PAD has no significant effect on Regional Expenditure or Economic Growth. Conversely, the Balancing Fund has a positive and significant effect on Regional Expenditure and Economic

Growth. Meanwhile, Regional Expenditure has no significant effect on Economic Growth, thus unable to mediate the influence of PAD or the Balancing Fund on Economic Growth.

These findings indicate that the Balancing Fund remains a more dominant fiscal instrument in supporting regional development than Locally-Generated Revenue (PAD). Furthermore, increased regional fiscal capacity has not been fully accompanied by allocations of Regional Expenditures capable of effectively driving economic activity. Therefore, the success of fiscal decentralization is determined not only by the size of regional revenues, but also by the quality of management and effectiveness of regional government expenditure allocations.

**Suggestion**

This study aims to analyze the influence of Regional Original Revenue (PAD) and the Balancing Fund on Economic Growth, with Regional Expenditure as a mediating variable in regencies/cities in Central Java Province for the 2021–2025 period. The results show that PAD has no significant effect on Regional Expenditure or Economic Growth. Conversely, the Balancing Fund has a positive and significant effect on Regional Expenditure and Economic Growth. Meanwhile, Regional Expenditure has no significant effect on Economic Growth, thus unable to mediate the influence of PAD or the Balancing Fund on Economic Growth.

These findings indicate that the Balancing Fund remains a more dominant fiscal instrument in supporting regional development than Locally-Generated Revenue (PAD). Furthermore, increased regional fiscal capacity has not been fully accompanied by allocations of Regional Expenditures capable of effectively driving economic activity. Therefore, the success of fiscal decentralization is determined not only by the size of regional revenues, but also by the quality of management and effectiveness of regional government expenditure allocations.

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