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Fiscal Decentralization and The Keynesian Multiplier: Evidence From Indonesian Regional Governments

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ABSTRACT

Regional revenue components affect Economic Growth through different spending allocation mechanisms in Indonesia's fiscal decentralization system. This research analyze the transmission mechanism of Local Government Revenue, Transfer Revenue, and Other Legitimate Revenues to Economic Growth through the mediation of Operating Expenditure and Capital Expenditure in 38 regencies and cities in East Java Province for the period 2019-2023. The study uses a quantitative methodology with multiple linear regression analysis and path analysis on panel data consisting of 190 observations, with data sources from the Directorate General of Fiscal Balance and the Central Statistics Agency. The findings show that all revenue components have a direct negative effect on economic growth, confirming the Keynesian economic theory that government revenue mobilization creates a contractionary effect without proper spending allocation. Operating Expenditure shows a greater influence in stimulating economic growth than Capital Expenditure. Path analysis shows that Local Government Revenue and Transfer Revenue contribute positively to Economic Growth through the mediation of Operating Expenditure. The results of the study provide fundamental policy implications for optimizing the composition of regional spending in order to maximize the fiscal multiplier effect and increase the effectiveness of economic stimulus in regional development strategies.

Keywords: *economic growth; keynesian theory; local government revenue; operating expenditure; transfer revenue.*

INTRODUCTION

Decentralization is a path to regional independence. It can be achieved through continued improvement in economic growth. Economic growth depends on the inflow and use of existing funds. Appropriate use of funds can have a multiplier effect that boosts economic growth. The recent phenomenon of funds sitting in local government accounts can lead to missed economic growth momentum (Irianto, 2025).

Economic Growth is a government indicator in evaluating the success of development and the welfare of households and businesses in a region which is reflected in the increase in the production of goods and services in a certain period. Economic Growth will have an impact on the welfare of individuals and businesses as well as the performance of other economic sectors (Jungo, 2024). Good Economic Growth will enlarge and provide jobs for the wider community if all sectors develop and grow (Babal et al., 2021). Sohag et al. (2019) The positive impact of Economic Growth is providing justice for all levels of society. Given the critical importance of economic growth in achieving societal welfare and development objectives, understanding the mechanisms that drive such growth becomes paramount for policymakers. This imperative has led to increased scholarly attention on the role of government fiscal policies, particularly in the context of evolving governance structures that emphasize decentralization.

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Regional Economic Growth, measured through Gross Regional Domestic Product growth rates, represents the outcome variable in fiscal decentralization studies. Afriliana & Wahyudi (2022) conceptualize economic growth as economic activities that increase output of goods and services, thereby enhancing community welfare. The relationship between regional government revenue, expenditure, and economic growth operates through multiple channels. Hardi et al. (2024) demonstrate that government integrity and tax burden positively influence economic growth, indicating government's crucial role in establishing effective regulatory frameworks and efficient fiscal policies. Contemporary research validates fiscal policy effectiveness in promoting economic growth. Tilahun Mengistu (2022) confirms that fiscal policy approaches toward economic growth show significant positive impacts from both private and government investment. Similarly, Poku et al. (2022) establish that government expenditure serves as an effective fiscal policy tool for promoting economic growth, particularly in short-term periods.

The Keynesian framework posits that government expenditure serves as a crucial component of aggregate demand, with spending multipliers amplifying the initial fiscal stimulus through successive rounds of economic activity (Keynes, 1936). Recent research by Kolista Moedy & Ling (2024) confirms that government spending in Indonesia generates positive multiplier effects, yet their analysis focuses primarily on national-level expenditures. The effectiveness of this mechanism in decentralized systems remains understudied, particularly in developing countries where institutional capacity and fiscal autonomy vary substantially across regions (Nsor-Ambala & Asafo-Adjei, 2023).

Indonesia's fiscal decentralization framework assigns substantial revenue and expenditure responsibilities to regional governments, theoretically enabling them to function as autonomous fiscal actors capable of influencing local economic outcomes. The fiscal federalism literature, particularly Oates' decentralization theorem (1972, 1999), suggests that subnational governments possess informational advantages in identifying local preferences and needs, potentially making their spending more efficient and effective than centralized allocation. When combined with Keynesian multiplier effects, this proximity advantage could theoretically amplify the economic impact of government spending (Clifford et al., 2023).

The intersection of fiscal decentralization and Keynesian economics presents a compelling framework for understanding how government spending affects economic growth across different administrative levels. While Keynesian theory traditionally focuses on national-level fiscal policy (Christiano et al., 2011), the global trend toward fiscal decentralization raises fundamental questions about whether and how government spending multipliers operate at subnational levels. Recent studies have shown mixed evidence on this relationship, with some finding positive effects of decentralized spending on growth (Sofilda et al., 2023); (Tilahun Mengistu, 2022) while others report insignificant or conditional impacts (V. Adur, 2024); (Solihin et al., 2021).

In Indonesia, this policy is outlined in Undang-Undang Republik Indonesia Number 1 Of 2022 concerning Relations Between Central Government and Regional Government. Regional governments possess authority in managing Regional Revenue and Expenditure, including exploring territorial revenue potential and arranging budget expenditure according to regional needs and priorities. The Central Government provides proportional transfer fund assistance to address tax revenue potential differences across regions. Regional Revenue and Expenditure Management follows Menteri Dalam Negeri Republik Indonesia Regulation Number 77 of 2020 concerning Technical Guidelines for Regional Financial Management. Regional Revenue consists of Local Government Revenue (PAD), Transfer Revenue, and Other Legitimate Revenue, while Regional Expenditure comprises Operating Expenditure, Capital Expenditure, Unexpected Expenditure, and Transfer Expenditure.

Despite extensive research on fiscal decentralization and Economic Growth, several research gaps persist in the literature. First, previous studies show inconsistent results regarding the relationship between capital expenditure and economic growth. V. Adur (2024) and Wiraswasta et al. (2019) found positive influence of Local Government Revenue on Capital Expenditure, while Puspitasari et al. (2023) concluded no significant influence. Similarly, studies on Capital Expenditure's impact on economic growth show mixed results, with Wiraswasta et al. (2019) and Pangestu (2018) finding positive effects, while Puspitasari et al. (2023), V. Adur (2024) and Mawaddah et al. (2024) found non-significant relationships.

Second, previous research tends to examine individual components within broader revenue categories rather than comprehensive analysis of all revenue sources. For instance, Herdiyana et al. (2024) and Puspitasari et al. (2023) focus on specific transfer components like General Allocation Fund, yielding contradictory conclusions about their impact on Capital Expenditure. Third, many studies still utilize outdated expenditure classifications such as direct and indirect expenditure rather than current regulatory nomenclature established in Menteri Dalam Negeri Republik Indonesia Regulation Number 77 of 2020.

Fourth, limited research comprehensively examines the mediating role of both operating and capital expenditures in the relationship between regional revenue components and economic growth. Most studies focus on either direct relationships or single expenditure categories, missing the complete picture of how fiscal decentralization mechanisms translate revenue generation into economic outcomes. This study addresses these research gaps by providing comprehensive analysis of all regional revenue components effects on economic growth through both operating and capital expenditure mediation using current regulatory frameworks.

The research data for the period 2019 to 2023 was selected because during that period, the Indonesian economy was also under pressure due to the COVID-19 outbreak. This research is expected to yield accurate implications for accelerating regional economic growth. East Java Province presents a particularly instructive case for this analysis. As Indonesia's second-largest regional economy, contributing 14.38% to national GDP in 2023 (Badan Pusat Statistik, 2024). The COVID-19 pandemic period (2020-2021) included in our analysis provides an additional natural experiment for testing Keynesian principles in a decentralized system. The economic contraction with growth falling from 5.53% in 2019 to 2.33% in 2020 and then increasing slowly and steadily until 2023 and subsequent fiscal response at both national and regional levels offer insights into how decentralized fiscal systems respond to macroeconomic shocks and whether local government spending can effectively counteract economic downturns. This aligns with recent findings by Poku et al. (2022) on the countercyclical effectiveness of government spending.

Table 1. East Java's Economic Growth From 2019 to 2023

Year	**2019**	**2020**	**2021**	**2022**	**2023**
Economic growth	5.53%	2,33%	3,56%	5,34%	4,95%

Sources : BPS Processed Data

East Java provinces such as Surabaya, Gresik and Sidoarjo have different GRDP and local government financial structures compared to other regions such as Pacitan, Trenggalek and Tulungagung. This heterogeneity allows us to examine how fiscal decentralization and government spending multipliers operate across different economic contexts within a single institutional framework. Previous research on East Java by Safitri et al. (2021) found that regional government spending only affects economic growth in the short term, raising questions about the sustainability of fiscal stimulus effects.

Table 2. Data on Original Regional Income, Regional Transfers and GRDP in Billions of Rupiah in 2023

City	Local Government Revenue	Transfer Revenue	Gross Regional Domestic Product
Surabaya	5.771,82	3.832,96	459.030,7
Gresik	1.171,02	2.241,48	113.825,4
Sidoarjo	2.050,79	2.965,84	160.950,8
Pacitan	213,3	1.494,33	12.245
Trenggalek	267,18	1.606,1	14.212,1
Tulungagung	719,59	2.123,41	30.234,6

Sources : Ministry of Finance and BPS Processed Data

This study makes several contributions to the literature. First, this research is to analyze the influence of Local Government Revenue, Transfer Revenue, and Other Legitimate Revenue on economic growth through Operating Expenditure and Capital Expenditure mediation in regencies and cities across East Java Province during 2019-2023. Specific objectives include examining direct effects of revenue components on operating and capital expenditures, determining direct impacts of revenue components on economic growth, evaluating the influence of operating and capital expenditures on economic growth, and assessing indirect effects of revenue components on economic growth through expenditure category mediation. Finally, by using the latest regulatory framework Menteri Dalam Negeri Republik Indonesia Regulation Number 77 of 2020, this study ensures relevance to current policy discussions and addresses the nomenclature inconsistencies that may have contributed to mixed findings in previous research. The findings offer practical insights for regional policymakers regarding optimal allocation strategies for different revenue sources to maximize economic growth impacts through targeted expenditure approaches.

HYPOTHESIS DEVELOPMENT

Effect of Regional Revenue to Operating Expenditure

The relationship between regional revenue sources and operating expenditure reflects fundamental principles of public financial management within Indonesia's decentralized governance system, where Local Government Revenue provides discretionary resources that enhance regional autonomy in determining expenditure composition and timing. Widajantie (2021) and Nasrullah Ramadhan & Nur Rahardjo (2024) Local Government Revenue significantly influences regional expenditure patterns, including operational spending components that encompass personnel costs, goods and services procurement, subsidies, grants, and social assistance programs requiring predictable and flexible funding sources. Transfer Revenue serves as a crucial complement, Sulaeman & Silvia (2019) finding that General Allocation Funds significantly influence personnel and goods expenditure, while Rohmah & Rahardjo (2023) confirm that General Allocation Funds and Special Allocation Funds affect Regional Expenditure. Other Legitimate Revenue contributes to operational flexibility, Rohmah & Rahardjo (2023) and Nasrullah Ramadhan & Nur Rahardjo (2024) demonstrates these revenue sources positively influence regional fiscal capacity when combined with other revenue streams.

H_1 : Local Government Revenue positively influence Operating Expenditure.

H_2 : Transfer Revenue positively influence Operating Expenditure.

H_3 : Other Legitimate Revenue positively influence Operating Expenditure.

Effect of Regional Revenue to Capital Expenditure

Capital expenditure allocation decisions reflect strategic choices about long-term regional development priorities and infrastructure investment, where Local Government Revenue provides the foundation for sustained capital investment through predictable, locally controlled resources. V. Adur (2024) and Wiraswasta et al. (2019) provide empirical evidence that Local Government Revenue positively influences Capital Expenditure, while Transfer Revenue plays a particularly important role through specific instruments designed to support infrastructure development. Herdiyana et al. (2024), Wiraswasta et al. (2019), V. R. G. B. Adur et al. (2019) demonstrate that various Transfer Revenue components positively influence Capital Expenditure, with Special Allocation Funds directly targeting infrastructure needs and other transfer mechanisms providing general fiscal support for capital investment. Other Legitimate Revenue contributes through grant funding and emergency assistance, as confirmed by Suparta (2021) and Susilowati et al. (2021) these revenue sources significantly influence capital expenditure levels, particularly when combined with other funding sources for major infrastructure initiatives.

H_4 : Local Government Revenue positively influences Capital Expenditure.

H_5 : Transfer Revenue positively influences Capital Expenditure.

H_6 : Other Legitimate Revenue positively influences Capital Expenditure.

Effect of Regional Revenue, Regional Expenditure to Economic Growth

Regional revenue sources and expenditure categories demonstrate distinct pathways for directly influencing economic growth through both demand-side and supply-side mechanisms. Wiraswasta et al. (2019) and Sugiarto et al. (2023) provide empirical evidence that Local Government Revenue significantly influences Economic Growth both directly and through expenditure allocation effects, signaling favorable business environment conditions that attract additional private investment. Transfer Revenue influences Economic Growth primarily through addressing regional disparities and ensuring adequate public service provision,various transfer mechanisms positively influence Economic Growth by enabling regions to maintain essential services and pursue development initiatives. Purba & Simandjorang (2024), Sulaeman & Silvia (2019), and V. Adur (2024). Other Legitimate Revenue contributes to Economic Growth through development programs and capacity building, with Ayu & Septiani (2019) finding that grant provision to regional governments reflects high levels of community economic growth. Kolista Moedy & Ling (2024), Pangestu (2018), and Fitri & Putri (2019) Operating Expenditure contributes through immediate demand effects supporting consumption levels. Personnel expenditure positively influences economic growth through household income and consumption effects, while Mawaddah et al. (2024) confirms goods and services expenditure greatly helps regional gross domestic product growth and community welfare. Capital Expenditure influences Economic Growth through infrastructure development and productive capacity enhancement, Wiraswasta et al. (2019), Sinto et al. (2023), Edi Sucipto (2022), and Fitri & Putri (2019) providing consistent evidence that capital expenditure promotes economic growth through infrastructure development that reduces transaction costs and creates foundations for business development.

H_7 : Local Government Revenue positively influences Economic Growth.

H_8 : Transfer Revenue positively influences Economic Growth.

H_9 : Other Legitimate Revenue positively influences Economic Growth.

H_{10} : Operating Expenditure positively influences Economic Growth.

H_{11} : Capital Expenditure positively influences Economic Growth.

Regional Expenditure Mediated Regional Revenue to Economic Growth

The indirect relationships between regional revenue sources and Economic Growth through expenditure mediation reflect complex pathways through which fiscal policy influences regional development outcomes according to Keynesian multiplier framework principles. When Local Government Revenue is allocated to Operating Expenditure, it creates multiplier effects extending beyond immediate fiscal injection, Nasrullah Nasrullah Ramadhan & Nur Rahardjo (2024) Regional Original Revenue positively influences regional expenditure, which through Keynesian multiplier effects promotes economic growth. Sugiarto et al. (2023) specifically find that Regional Taxes mediated by Regional Expenditure have a significant influence on Economic Growth, providing direct evidence for the mediation relationship. The allocation of Local Government Revenue to Capital Expenditure creates longer-term Economic Growth effects through infrastructure development. Regional Original Revenue has a significant effect on Economic Growth through Capital Expenditure (Wiraswasta et al., 2019), while Puspitasari et al. (2023) that regional revenue components influence Capital Expenditure, generating investment multiplier effects according to Keynesian theory. Transfer Revenue demonstrates similar indirect growth effects, Special Allocation Funds affect Economic Growth through Capital Expenditure V. R. G. B. Adur et al. (2019) and Edi Sucipto (2022) confirms that Special Allocation Funds and Revenue Sharing Funds affect Economic Growth through direct expenditure. Other Legitimate Revenue sources also demonstrate mediation effects, these revenue sources significantly influence capital expenditure, which according to Keynesian theory generates positive economic growth effects through infrastructure development and productive capacity enhancement (Suparta, 2021),(Susilowati et al., 2021). Therefore, this study hypothesizes that Regional Original Revenue, Transfer Revenue, and Other Legitimate Regional Revenue positively influence economic growth through both operating expenditure and capital expenditure mediation mechanisms.

According to the discussion above, the conceptual framework is as follows:

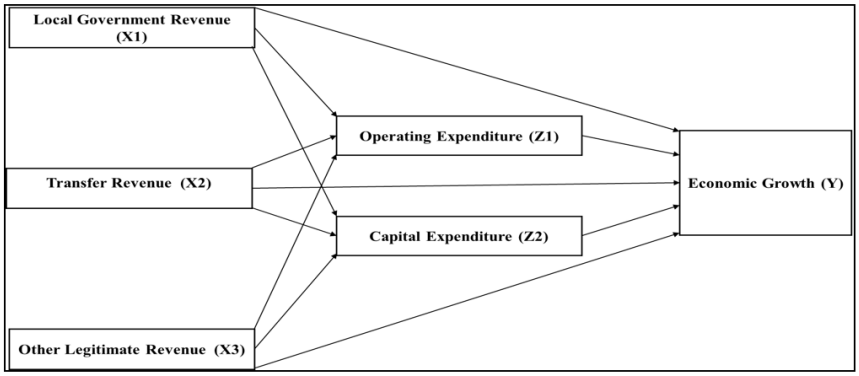

Figure 1. Conceptual Framework

H_{12} : Local Government Revenue positively influences economic growth through operating expenditure mediation.

H_{13} : Transfer Revenue positively influences Economic Growth through Operating Expenditure mediation.

H_{14} : Other Legitimate Revenue positively influences Economic Growth through Operating Expenditure mediation.

H_{15} : Local Government Revenue positively influences Economic Growth through Capital Expenditure mediation.

H_{16} : Other Legitimate Revenue positively influences Economic Growth through Capital Expenditure mediation.

H_{17} : Other Legitimate Revenue positively influences Economic Growth through Capital Expenditure mediation.

METHOD, DATA, AND ANALYSIS

The research uses a quantitative research using panel data methodology and sensus Population. Panel data methodologi combining cross sectional data dan time series and sensus population which takes the entire population being studied (Candrarin, 2017). This research combining cross-sectional data from 38 regencies and cities in East Java Province with time series data spanning 2019-2023, resulting in 190 total observations.

Secondary data are collected from official government sources, revenue and expenditure data from the Directorate General of Fiscal Balance (DJPK) Ministry of Finance https://djpk.kemenkeu.go.id , and Gross Regional Domestic Product data from the Central Statistics Agency (BPS) East Java Province https://jatim.bps.go.id . Data collection follows systematic documentation procedures to ensure reliability and validity.

This operational framework ensures consistent measurement across all variables while maintaining alignment with Indonesian governmental accounting standards and regulatory requirements established in Peraturan Menteri Dalam Negeri Number 77 of 2020. Economic Growth according to (Afriliana & Wahyudi, 2022).

Table 3. Operational Definition Of Variables

Variable	Definition	Formula
Local Government Revenue	Revenue obtained by regions from sources within their own territories collected based on regional regulations, reflecting regional fiscal independence in financing government and development activities	LGR = Ln Regional Taxes + Regional Levies + Separated Regional Wealth Management Results + Other Legal Regional Original Revenue
Transfer Revenue	Revenue originating from other reporting entities as consequences of inter-governmental financial relationships, aimed at reducing fiscal gaps and supporting equitable public service provision	TR = Ln Central Government Transfer + Inter-Regional Transfer
Other Legitimate Revenue	Regional revenue not included in Regional Original Revenue or Transfer Revenue categories, comprising non-binding assistance and emergency support.	OLR = Ln Grants + Emergency Funds+ other legitimate income according to legislation
Operating Expenditure	Budget expenditure for regional government daily activities providing short-term economic benefits, influencing public consumption and immediate economic activity.	OE = Ln Personnel Expenditure+ Goods and Services Expenditure + Interest Expenditure + Subsidy Expenditure + Grant Expenditure + Social Assistance Expenditure
Capital Expenditure	Budget expenditure for acquiring fixed assets and infrastructure providing benefits exceeding one accounting period, supporting long-term economic development and investment facilitation.	CE= Land Expenditure + Equipment and Machinery Expenditure + Building and Construction Expenditure + Road, Irrigation, and Network Expenditure + Other Fixed Asset Expenditure + Other Asset Expenditure
Economic Growth	Annual percentage change in regional economic output representing increased production of goods and services, measured through real gross regional domestic product expansion	EG = Ln Economic Growth = [($GRDP_{[t]}$ - $GRDP_{[t-1]}$) / $GRDP_{[t-1]}$] × 100% (based on 2010 constant prices)

The analytical framework begins with descriptive statistics and classical assumption tests. Three regression models examine: first, the effects of revenue components on Operating Expenditure; second, revenue components impact on Capital Expenditure; and third, how revenue and expenditure variables influence Economic Growth. Path analysis quantifies direct and indirect relationships, with indirect effects calculated through coefficient multiplication. In This Research, the author used SPSS 27 to process the data. The path analysis model consists of three substructures:

Sub Structure 1 : $Z_1 = \alpha + \beta_1 X_1 + \beta_{12} X2 + \beta_{13} X_3 + \varepsilon$

Sub Structure 2 : $Z_2 = \alpha + \beta_{21} X_1 + \beta_{22} X2 + \beta_{23} X_3 + \varepsilon$

Sub Structure 3 : $Y = \alpha + \beta_{31} X_1 + \beta_{32} X_2 + \beta_{33} X_3 + \beta_{34} Z_1 + \beta_{35} Z_2 + \varepsilon$

Description:

X1 = Local Government Revenue
X2 = Transfer Revenue
X3 = Other Legitimate Revenue
Z1 = Operating Expenditure
Z2 = Capital Expenditure
Y = Economic Growth
α = Constanta
β = Coefisien
ε = error

RESULT AND DISCUSSION

Result

Based on the results of descriptive statistical analysis of 190 observations from 38 regencies and cities in East Java Province for the 2019-2023 period, the fundamental characteristics of the research variables that reflect the complexity of regional financial management in Indonesia's fiscal decentralization system can be explained.

Table 4. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Local Government Revenue	190	131,83	5.771,82	565,49	816,86
Transfer Revenue	190	637,43	5.064,76	1.897,98	798,84
Other Legitimate Revenue	190	0,00	654,41	73,66	89,27
Operating Expenditure	190	648,14	7.858,87	1.761,28	1.058,83
Capital Expenditure	190	69,35	2.754,30	396,17	358,04
Economic Growth	190	-6,46	8,88	2,94	3,41

The average Local Government Revenue in East Java is below the middle limit, or can be called low. Regional Government Revenue shows a very significant disparity, indicating an imbalance in fiscal capacity between regions. The range of values between 131,83 billion rupiah to 5.771,82 billion rupiah with an average of 565,49 billion rupiah reflects the very diverse economic structure of East Java Province. The lowest value is the city of Pasuruan while the highest value is the city of Surabaya. The regional tax component as the main source of PAD shows variations that reflect differences in tax bases between regions.

Transfer Revenue shares a similar pattern to Local Government Revenue. Based on the average, Transfer Revenue falls below the middle or low limit. Overall, the average value of each variable is below the middle limit, or can be said to be low. However transfer revenue with an average of 1.897,98 billion rupiah and a standard deviation of 798,84 shows better variation compared to PAD, which reflects the design of the transfer policy aimed at reducing the fiscal gap. The central government provides a proportional distribution of income with regional contributions to national tax revenues. This is reflected in the lowest value 637,43 bilion rupiah being Mojokerto City in 2020 while the highest is Bojonegoro Regency 7.858,87. This is because the Bojonegoro area has a mineral sector that contributes taxes to the central government.

Other Legitimate Income with an average of 73,66 billion rupiah shows a minimal contribution. Not all regions have this source of income because it is only used under certain conditions. The grant component shows dependence on external assistance that cannot be predicted and controlled by the local government. Grants from the central government are generally allocated for specific programs such as school operational assistance, health assistance, or other special programs. Emergency funds as the second component show the frequency and magnitude of disasters that require external assistance. The 2019-2023 study period covering the COVID-19 pandemic showed an increase in emergency funds to address health and economic impacts. Variations in emergency funds between regions also reflect differences in exposure to natural disaster risks, with coastal and mountainous areas at higher risk.

Operational Expenditure with an average of 1.761,28 billion rupiah reflects operational needs that vary according to the scale of government and the complexity of public services. The highest value 7.858,87 billion rupiah is in the city of Surabaya in 2023 while the lowest value 648,14 billion rupiah is in the city of Mojokerto in 2020. The components of employee expenditure and goods and services expenditure have a large contribution to this expenditure. From a Keynesian perspective, employee expenditure and goods and services expenditure will have a multiplier effect on economic growth. In addition, there is a Subsidy Expenditure component that shows the commitment of local governments to maintaining the affordability of strategic products and services for the community.

Capital expenditure with an average of 396,17 billion rupiah shows relatively limited infrastructure investment compared to operating expenditure. The highest value was in the city of Surabaya in 2019 at 2.754,30 billion rupiah, while the lowest was in the city of Probolinggo in 2021 at 69,35. The relatively small proportion of capital expenditure to total regional expenditure reflects short-term priorities in regional budget management. In addition, during the pandemic, regions prioritized handling COVID-19 over physical development.

Economic growth with an average of 2,94 percent indicates moderate economic performance with high volatility. The standard deviation of 3,41 which is greater than the average indicates extreme fluctuations during the study period. Batu City has a minimum value of -6,46 percent reflecting the impact of the COVID-19 pandemic in 2020 which caused economic contraction through various channels. Mobility restrictions reduce household consumption, especially for the service sector such as hotels, restaurants, and transportation. Tuban Regency has a maximum value of 8.88 percent indicating the extraordinary resilience and recovery capabilities of several regions. This high growth reflects the effectiveness of fiscal stimulus, adaptation to new normal conditions, and the recovery effect after the previous year's contraction. Regions with a diversified economic structure and high adaptive capacity show faster recovery.

The classical assumption tests conducted in this study are residual normality, multicollinearity, heteroscedasticity, and autocorrelation tests.

Table 5. One Sample Kologoronov Smirnov

Structure	sig
Sub Structure 1	0,078
Sub Structure 2	.200d
Sub Structure 3	.200d

Source: Data Proceed SPSS 2025

Table 6. Multicollinearity

variabel	Sub Structure 1		Sub Structure 2		Sub Structure 3	
	tolerance	VIF	tolerance	VIF	tolerance	VIF
Local Government Revenue	0,538	1,859	0,538	1,859	0,270	3,699
Transfer Revenue	0,541	1,850	0,541	1,850	0,313	3,197
Other Legitimate Revenue	0,976	1,025	0,976	1,025	0,971	1,030
Operating Expenditure					0,112	8,904
Capital Expenditure					0,319	3,131

Source: Data Proceed SPSS 2025

Table 7. heteroscedasticity Glajser Test

Variabel	Sub Structure 1	Sub Structure 2	Sub Structure 3
		sig.	
constan	0,081	0,462	0,921
Local Government Revenue	0,140	0,551	0,269
Transfer Revenue	0,202	0,388	0,129
Other Legitimate Revenue	0,262	0,495	0,691
Operating Expenditure			0,465
Capital Expenditure			0,703

Source: Data Proceed SPSS 2025

Table 8. Autocorrelation Two Step Durbin Watson

Structure	durbin watson	dU	4-dU
Sub Structure 1	1,996	1,7947	2,2053
Sub Structure 2	2,026	1,7947	2,2053
Sub Structure 3	1,999	1,8168	2,1832

Source: Data Proceed SPSS 2025

The normality test of all substructures is above 0,05 so that it can be normal. The multicollinearity test tolerance value <1 and the VIF value <10 so that there is no multicollinearity. The gletjer test coefficient is above 0,05, so there is no heteroscedasticity. The Durbin Watson value is between dU and 4-dU, so there is no autocorrelation. Based on the classical assumption test that has been carried out, no violations of the assumptions were found so that the hypothesis can be tested.

Table 9. Result Test Sub Structure 1

variable	β	T	sig.	adj.R Square	F	sig.
constan	1,736	10,088	<0,001	0,946	1.100,152	<,001b
Ln Local Government Revenue	0,355	24,385	<0,001			
Ln Transfer Revenue	0,494	21,419	<0,001			
Ln Other Legitimate Revenue	-0,028	-1,787	0,076			

Dependen Variable : Ln Operating Expenditure

The regression equation becomes : **Z = 1,736 + 0,355X + 0,494X, - 0,028X*f* +** ε

Adjusted R Square of 0,946 indicates that the variables Local Government Revenue, Transfer Revenue, Other Legitimate Revenue can explain Operating Expenditure by 94,6%. The results of the F test <0,05 indicate that all independent variables simultaneously affect Operating Expenditure. The t test shows that variables Local Government Revenue, and Transfer Revenue significance <0,05 then H_1 and H_2 are accepted. For Other Legitimate Revenue significance >0,05 and the t value is negative, then H_3 is rejected

Table 10. Result Test Sub Structure 2

variable	β	T	sig.	adj.R Square	F	sig.
constan	-1,767	-3,015	0,003	0,687	139,156	<,001b
Ln Local Government Revenue	0,320	6,456	<0,001			
Ln Transfer Revenue	0,770	9,813	<0,001			
Ln Other Legitimate Revenue	-0,022	-0,420	0,6751			

Dependen Variable : Ln Capital Expenditure

The regression equation becomes : **Z, = -1,767 + 0,320X + 0,770X, - 0,022X*f* +** ε

Adjusted R Square of 0,687 indicates that the variables Local Government Revenue, Transfer Revenue, Other Legitimate Revenue can explain Capital Expenditure by 68,7%. The results of the F test <0,05 indicate that all independent variables simultaneously affect Operating Expenditure. The t test shows that variables Local Government Revenue, and Transfer Revenue significance <0,05 then H_4 and H_5 are accepted. For Other Legitimate Revenue significance >0,05 and the t value is negative, then H_6 is rejected

Table 11. Result Test Sub Structure 3

variabel	β	T	sig.	adj.R Square	F	sig.
constan	0,037	0,071	0,943	0,651	71,420	<,001b
Ln Local Government Revenue	-0,793	-15,201	<0,001			
Ln Transfer Revenue	-0,728	-9,460	<0,001			
Ln Other Legitimate Revenue	-0,115	-2,908	0,004			
Ln Operating Expenditure	1,639	13,559	<0,001			
Ln Capital Expenditure	0,109	2,298	0,023			

Dependen Variable : Ln Economic Growth

The regression equation becomes : **Y = 0,037 - 0,793X - 0,728X, - 0,115X*f* + 1,639Z + 0,109Z, +** ε

Adjusted R Square of 0,651 indicates that the variables of Local Government Revenue, Transfer Revenue, Other Legitimate Revenue, Operating Expenditure and Capital Expenditure can explain Economic Growth by 65,1%. The results of the F test <0,05 indicate that all independent variables simultaneously affect Economic Growth. The t test shows that Local Government Revenue, Transfer Revenue and Other Legitimate Revenue have a significance of <0,05 but have a negative t value, so H_7, H_8 and H_9 are rejected. For Operating Expenditure and Capital Expenditure, they have a significance of <0,05 and are positive, so H_{10} and H_{11} are accepted.

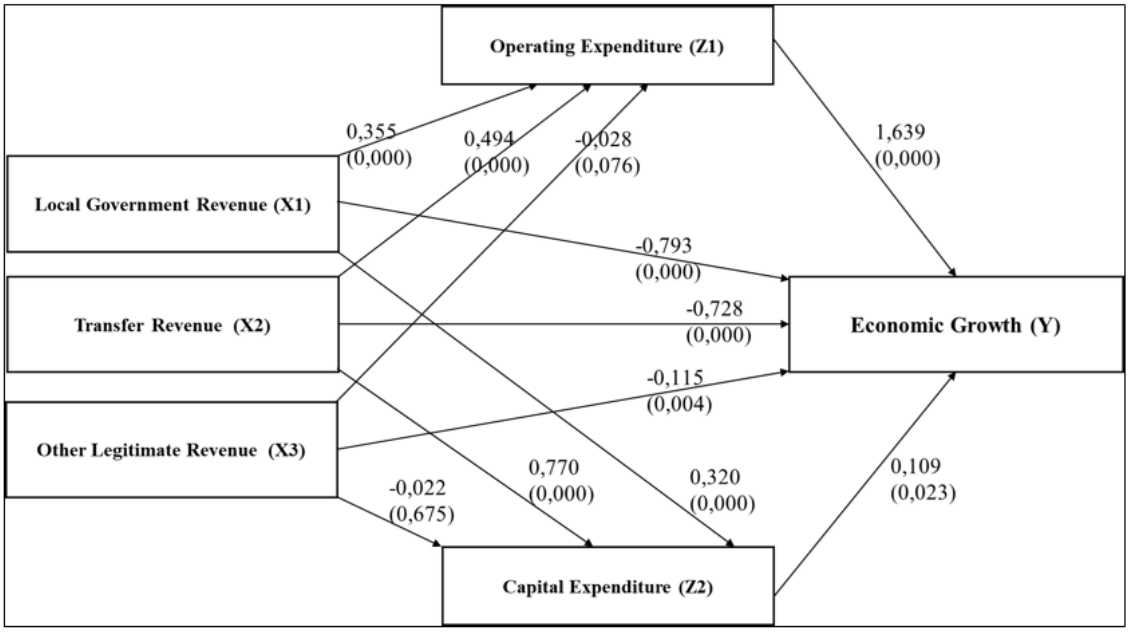

Figure 2. Path Diagram

Table 12. Path Coefficient

Variable	Direct Effect	Direct Effect	Direct Effect	Indirect Effect	Description
$X_1 \rightarrow Z_1 \rightarrow Y$	$X_1 \rightarrow Z_1$ 0,355***	$Z_1 \rightarrow Y$ 1,639***	$X_1 \rightarrow Y$ -0,793***	0,582	Partial Mediation
$X_2 \rightarrow Z_1 \rightarrow Y$	$X_2 \rightarrow Z_1$ 0,494***	$Z_1 \rightarrow Y$ 1,639***	$X_2 \rightarrow Y$ -0,728***	0,810	Partial Mediation
$X_3 \rightarrow Z_1 \rightarrow Y$	$X_3 \rightarrow Z_1$ -0,028*	$Z_1 \rightarrow Y$ 1,639***	$X_3 \rightarrow Y$ -0,115**	-0,046	Not Mediation
$X_1 \rightarrow Z_2 \rightarrow Y$	$X_1 \rightarrow Z_2$ 0,320***	$Z_2 \rightarrow Y$ 0,109**	$X_1 \rightarrow Y$ -0,793***	0,035	Partial Mediation
$X_2 \rightarrow Z_2 \rightarrow Y$	$X_2 \rightarrow Z_2$ 0,770***	$Z_2 \rightarrow Y$ 0,109**	$X_2 \rightarrow Y$ -0,728***	0,084	Partial Mediation
$X_3 \rightarrow Z_2 \rightarrow Y$	$X_3 \rightarrow Z_2$ -0,022	$Z_2 \rightarrow Y$ 0,109**	$X_3 \rightarrow Y$ -0,115**	-0,002	Not Mediation

Legend : *sig 0,10;**sig 0,05;*** sig 0,001

Based on the results of multiple linear regression, the results of the path analysis show that the direct influence given by Local Government Revenue on Economic Growth is -0,793. While the indirect influence of Local Government Revenue on Economic Growth through Operating Expenditure is 0,355 x 1,639 = 0,582 or >-0,793, it is concluded that H_{12} is accepted. For the indirect influence of Local Government Revenue on Economic Growth through Capital Expenditure is 0,320 x 0,109 = 0,035 or >-0,793, it is concluded that H_{15} is accepted.

The Transfer Revenue variable on Economic Growth has a direct influence of -0,728. While the indirect influence of Transfer Revenue on Economic Growth through Operating Expenditure is 0,494 x 1,639 = 0,810 or >-0,728, it is concluded that H_{13} is accepted. for the indirect effect of Transfer Revenue on Economic Growth through Capital Expenditure is 0,077 x 0,109 = 0,084 or >-0,728, it is concluded that H_{16} is accepted.

Other Legitimate Revenue variables on Economic Growth have a direct effect of -0,115. While the indirect effect of Other Legitimate Revenue on Economic Growth through Operating Expenditure

is -0,028 x 1,639 = -0,046 or <-0,115, it is concluded that H_{14} is rejected. for the indirect effect of Other Legitimate Revenue on Economic Growth through Capital Expenditure, namely -0,022 x 0,109 = -0.002 or <-0,115, but because in the direct effect this variable is not significant, it is concluded that H_{17} is rejected.

DISCUSSION

Impact Regional Revenue to Operating Expenditure

Local Government Revenue shows a positive and significant effect on Operating Expenditure with a coefficient of 0,355, which confirms Oates (1999) fiscal decentralization theory that fiscal independence provides flexibility in allocating funds for operational needs. This finding is in line with research by Widajantie (2021) and Nasrullah Ramadhan & Nur Rahardjo (2024) showing that regions with high Local Government Revenue have wider fiscal space to finance public services.

Transfer Revenue shows a more dominant role with a coefficient of 0,494 which is greater than Local Government Revenue. This can happen because based on table 2, only Surabaya City has Regional Income that is greater than Transfer Income. This confirms the effectiveness of the fiscal transfer design, especially the General Allocation Fund, in ensuring regional operational capacity. This also confirms regional fiscal dependence on the central government. This finding supports research by Sulaeman & Silvia (2019) and Rohmah & Rahardjo (2023) which proves the crucial role of transfers in funding sustainable operational expenditures.

Other Legitimate Revenue does not show a significant effect on Operating Expenditure with a coefficient of -0,028. This insignificance is due to the characteristics of grants and emergency funds which are non-routine, unpredictable, and have special allocations that are not allocated for routine operational expenditures. This finding indicates that conditional revenue sources have limitations in supporting the daily operational needs of local governments. This result is different from the research by Rohmah & Rahardjo (2023) which found a positive effect, but is in line with the reality that grants are usually allocated for specific programs or activities that are not included in the category of daily operational expenses.

Impact Regional Revenue to Capital Expenditure

The analysis shows that Regional Revenue sources have varying capacities in driving infrastructure investment through Capital Expenditure. Local Government Revenue is proven to have a positive and significant effect on Capital Expenditure with a coefficient of 0,320, confirming that fiscal independence provides flexibility in determining infrastructure development priorities. This finding is consistent with V. Adur (2024) and Wiraswasta et al. (2019), showing that Local Government Revenue sourced from regional taxes and regional levies provides certainty of long-term funding for fixed asset investment.

Transfer Revenue shows a more dominant role with a coefficient of 0,770 which is greater than Local Government Revenue, confirms that regional fiscal dependence on the central government. This reflects the effectiveness of the transfer policy design, especially the Physical Special Allocation Fund, which is specifically allocated for national priority infrastructure investment. This finding is in line with Herdiyana et al. (2024) and V. R. G. B. Adur et al. (2019) that the transfer system not only reduces the fiscal gap but also ensures equitable distribution of infrastructure development between regions.

Other Legitimate Revenue does not show a significant effect on Capital Expenditure with a coefficient of -0,022. This insignificance is due to the characteristics of grants that have allocations that

have been determined by the grantor and emergency funds that are intended for urgent post-disaster needs, not for systematic capital investment. The difference with the findings of Suparta (2021) and Susilowati et al. (2021) can be explained by the variation in grant types and the uncertainty of receiving emergency funds that depend on special events.

Impact Regional Revenue, Regional Expenditure to Economic Growth

The results of the study indicate that Local Government Revenue has a negative and significant effect on Economic Growth with a coefficient of -0,793 and significance <0,001, Transfer Revenue also shows a negative and significant effect on Economic Growth with a coefficient of -0,728 and significance <0,001 and Other Legitimate Revenue has a negative and significant effect on Economic Growth with a coefficient of -0,115 and significance 0,004. This finding contradicts the hypothesis that predicts a positive relationship, but can be explained through a deeper theoretical context. First, this phenomenon is called economic leakage. Economic leakage is a condition where there is potential regional income but it cannot be enjoyed economically by the region due to the community's consumption patterns that spend their income on products from outside the region, resulting in no increase in the production of goods and services, so that the regional economy does not rotate(Nurjihadi, 2016). On the other hand, local entrepreneurs send the results of resources without downstreaming within the region, resulting in economic value being created outside the region. This condition causes, despite regional income, Economic Growth to be negative. Second, according to Keynesian theory, government revenue cannot directly affect economic growth without being allocated to spending that can stimulate aggregate demand. Research when the covid-19 pandemic also affected the pattern of negative economic growth so that regional income collected from community taxes could not be maximally received.

The negative effect of Local Government Revenue on Economic Growth indicates that in the context of this study, the increase in Local Government Revenue sourced from regional taxes and regional levies actually burdens the community and reduces their purchasing power. This is in line with the principle that taxes are transfers from the private sector to the public sector that can reduce private consumption and investment if not balanced with effective spending allocation. This finding confirms the importance of the mediation effect of regional spending in changing the negative impact of Local Government Revenue into a positive impact on economic growth.

The negative impact of Transfer Revenue can also be explained that high Transfer Revenue in a region indicates high fiscal dependency and relatively low local economic capacity. Regions that receive high transfers are generally regions with a weak economic base, so the negative correlation with economic growth can be understood as a reflection of underlying economic conditions.

Other Legitimate Revenue although its contribution is relatively small compared to Local Government Revenue and Transfer Revenue, this negative impact is consistent with the same theoretical explanation. Grants and emergency funds as the main components cannot directly affect economic growth without being allocated to programs or activities that can stimulate economic activity.

Operating Expenditure has proven to be a very effective economic stimulus instrument with a coefficient of 1,639, confirming the Keynesian theory of the multiplier effect of government spending on aggregate demand. The large coefficient indicates that each unit increase in operating expenditure produces a greater economic impact through stimulating public consumption via employee spending, goods and services spending, subsidies, and social assistance. This finding is in line with Kolista Moedy & Ling (2024), Pangestu (2018), and Mawaddah et al. (2024) the superiority of operating expenditure in

driving short-term economic growth by increasing purchasing power and consumption of people who have high velocity in local economic circulation.

Capital Expenditure shows a positive effect with a more moderate but still significant coefficient of 0,109. Infrastructure investment through spending on land, equipment and machinery, buildings and structures, and roads and networks creates a foundation for long-term economic growth by increasing productivity and creating a conducive environment for private investment. These results support research by Wiraswasta et al. (2019), Sinto et al. (2023) and Edi Sucipto (2022). The smaller coefficient compared to operating expenditure reflects the characteristics of infrastructure investment which requires a longer gestation period to provide optimal economic impact, but still makes a significant contribution to sustainable economic development.

Impact Regional Expenditure Mediated Regional Revenue to Economic Growth

The mediation that occurs in Local Government Revenue on Economic Growth through Regional Expenditure is partial mediation, because Local Government Revenue has a direct and indirect influence on Economic Growth. This shows that the amount of money received determines economic growth.

Path analysis shows that Local Government Revenue has a positive effect on Economic Growth through Operating Expenditure with a path coefficient of 0,582. This finding confirms that although Local Government Revenue has a negative direct effect on Economic Growth, through the allocation of Operating Expenditure, Local Government Revenue can provide a substantial positive contribution to economic growth. This result strongly supports the Keynesian theory and Sugiarto et al. (2023) which emphasizes the importance of government spending in converting fiscal resources into economic stimulus. Local Government Revenue allocated for Operating Expenditure creates a strong multiplier effect through various channels. The positive and substantial path coefficient of 0,582 indicates that the positive effect of Local Government Revenue through operating expenditure is greater than its direct negative effect. This indicates that the policy of increasing Local Government Revenue will benefit Economic Growth if followed by an effective allocation of Operating Expenditure.

Transfer Revenue has a large mediation effect through Operating Expenditure with a path coefficient that exceeds the mediation effect of Local Government Revenue. This effective transmission mechanism can be explained through three main factors. First, Transfer Revenue has a more certain allocation for operating expenditure according to its design, especially the General Allocation Fund which is explicitly intended to finance operational needs including employee expenditure and goods and services expenditure. Second, transfers from the central government do not reduce the purchasing power of local communities as Local Government Revenue which comes from taxes and levies, thus creating a pure stimulus without a contractionary effect. Third, Transfer Revenue is often allocated to regions with relatively lagging economic conditions, where the multiplier effect has the potential to be higher due to the higher marginal consumption rate (Purba & Simandjorang, 2024) and (Sulaeman & Silvia, 2019).

Operating Expenditure does not mediate Other Legitimate Revenue on Economic Growth with a path coefficient of -0.046. This result confirms that grants and emergency funds as the main components of Other Legitimate Income, namely grants and emergency funds allocated for routine operational expenditure, are not large enough so that they cannot contribute to economic growth through the operational expenditure mechanism.

Local Government Revenue has a positive effect on Economic Growth through Capital Expenditure with a coefficient of 0,035. Although the coefficient is relatively small, this finding confirms that fiscal

independence allows regions to make infrastructure investments according to local priorities. Local Government Revenue provides flexibility to plan long-term investments in land, equipment and machinery, buildings and structures, and other infrastructure that create the foundation for sustainable growth. The moderate magnitude of the coefficient reflects the characteristics of infrastructure investment that has a long gestation period and long-term impact. This finding is in line with the research of Wiraswasta et al. (2019) and supports the theory of fiscal decentralization on the efficiency of resource allocation when local governments have autonomy in financing infrastructure investment.

Transfer Revenue has a positive effect on Economic Growth through Capital Expenditure with a coefficient of 0,084, which is greater than the Local Government Revenue path. This effectiveness reflects the strategic design of transfer policies, especially through the Physical Special Allocation Fund which is specifically allocated for national priority infrastructure investment based on technical criteria and regional needs. The three main influencing factors are First, transfers have components that are specifically allocated for capital expenditures such as Physical DAK. Second, transfers are often directed to areas that require more intensive infrastructure development. Third, coordination between the central and regional governments in infrastructure planning increases investment effectiveness. This finding is in line with research V. Adur (2024)Vand Edi Sucipto (2022) the effectiveness of transfer policies in encouraging equitable infrastructure development and long-term economic growth through coordinated and targeted allocations.

Other Legitimate Revenue has no significant effect on Economic Growth through Capital Expenditures with a path coefficient of -0,002. This insignificance is a consequence of the insignificant influence of Other Legitimate Revenue on Capital Expenditures in the first stage of path analysis. Grants as the main component are generally allocated for specific programs or activities that are not included in the capital expenditure category. Emergency funds are also allocated for responsive and short-term post-disaster rehabilitation and recovery purposes, not for systematic long-term infrastructure investment.

CONCLUSION AND SUGGESTION

This research successfully confirms the validity of Keynesian economic theory in the context of fiscal decentralization, with the finding that regional revenue can only drive Economic Growth through conversion into effective spending. The results of the analysis of 38 districts and cities in East Java Province for the period 2019-2023 show that although all components of regional revenue (Local Government Revenue, Transfer Revenue, and Other Legitimate Revenue) have a direct negative effect on economic growth, they can provide a significant positive contribution through the mediation of Operating Expenditure and Capital Expenditure. The most significant finding is that the Operating Expenditure path is greater than Capital Expenditure, confirming the effectiveness of consumption stimulus for short-term Economic Growth. This study provides theoretical contributions by validating Keynesian theory at the subnational level and methodologically through path analysis that successfully unravels the complex transmission mechanism between income and economic growth through the mediation variable of regional spending.

For further research to consider the normal period, because this research was conducted during the covid 19 period where economic instability occurred so that it does not reflect the economic conditions under normal circumstances. In addition, further research can consider social aspects such as population and area.

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