

THE INFLUENCE OF FINANCIAL PERFORMANCE ON ECONOMIC GROWTH AND INCOME DISPARITY IN INDONESIA

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Abstract: This study aims to determine and test the effect of the regional financial effectiveness ratio and the regional financial efficiency ratio on economic growth and income disparity in Indonesia. This research is quantitative and descriptive analysis using secondary data obtained from the publication of the Central Statistics Agency (BPS) in the form of panel data consisting of a combination of cross-section data, namely in 34 provinces in Indonesia and time series data from 2020 - 2024. The analysis method in this study uses multiple linear regression tests with the help of the Eviews 12 analysis tool. The results of the study partially indicate that regional financial effectiveness has a positive and significant effect on economic growth, while regional financial efficiency has a negative and insignificant effect on economic growth. In addition, regional financial effectiveness and regional financial efficiency have a positive and insignificant effect on income disparity. Simultaneously, regional financial effectiveness and regional financial efficiency have a significant effect on economic growth in Indonesia, while regional financial effectiveness and regional financial efficiency have no effect on income disparity in Indonesia.

Keyword: *Economic Growth; Income Disparity; Regional Financial Effectiveness; Regional Financial Efficiency*

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1. Introduction

High economic growth serves as an indicator of a nation's or region's development success. However, aggregate growth figures often mask the reality of unequal wealth distribution. The phenomenon of "growth with inequality" presents a significant challenge, as rising GDP does not automatically "trickle down" to reduce income disparities. Wide inequality across different strata of society is not merely a social issue; it can also hinder long-term economic sustainability. Theoretically, effective and efficient budget allocation should foster economic growth while simultaneously curbing inequality, given that the purpose of fiscal decentralization is to accelerate regional development.

Table 1. Economic Growth and Gini Ratio in Indonesia 2020 – 2024

Year	Economic Growth (%)	Gini Ratio (Index)
2020	-2,07	0,381
2021	3,70	0,384
2022	5,31	0,384
2023	5,05	0,388
2024	5,03	0,379

Source: Central Statistics Agency (2025)

In 2020, a contraction of -2.07% showed the vulnerability of the economic structure

which led to an economic recession caused by the COVID-19 pandemic. During the recovery and normalization period in 2021 – 2023, economic growth will return to 5% in 2022. In 2024, the figure of 5.03% shows that the Indonesian economy is quite stable (resilient).

Indonesia's Gini ratio has shown a downward trend. Economic dynamics in Indonesia between 2020 and 2024 have been contradictory; while the country recorded robust economic growth of 5.31% in 2022, the Gini ratio remained at 0.384. This indicates that economic acceleration has not yet fully succeeded in significantly reducing income disparity.

The regional financial effectiveness ratio is largely classified as effective, with a peak of 99.37% in 2024 and a low of 91.06% in 2022. This reflects the local government's relative ability to meet revenue targets, although it has not yet reached the "Highly Effective" category (>100%). Conversely, the efficiency ratio indicates that the years 2020, 2021, and 2023 fell into the "Inefficient" category, while 2022 and 2024 were classified as "Less Efficient." This suggests that realized expenditure was relatively high compared to revenue capacity. These findings indicate that while revenue targets were met effectively, expenditure management lacked full efficiency, potentially constraining the local government's fiscal space.

Although the implementation of fiscal decentralization in Indonesia aims to foster regional self-reliance and prosperity, a paradox exists between regional financial performance and the quality of resulting economic development. On one hand, improved regional financial performance—measured by the effectiveness and efficiency of local budget management—has proven capable of accelerating regional economic growth. On the other hand, however, such growth is often not accompanied by an equitable distribution of development outcomes.

Regional expenditure allocations focused on administrative efficiency often overlook aspects of distributive justice, as capital expenditure and regional investments tend to concentrate on capital-intensive sectors within growth centers (urban areas). Consequently, improved financial performance risks widening income disparities between regions and among different segments of society.

The uncertainty regarding whether the efficiency and effectiveness of regional finance act as drivers of equitable distribution or, conversely, trigger economic inequality constitutes the core research problem of this study.

2. Literature Review

2.1 Theoretical Overview

Economic Growth

According to Martinez and McNab (2003), the relationship between fiscal decentralization and economic growth is multidimensional, the direct relationship is based on the opinion of Oates (1993) who stated that the provision of public goods within the framework of fiscal decentralization will increase the efficiency that will be achieved in line with the setting of economic growth achieved. The direct relationship between fiscal decentralization and economic growth as expressed by Oates (1993) still requires further development, but there are several potentials that can be developed regarding the problem of the indirect relationship between fiscal decentralization and economic growth.

Income Disparity

Income disparity is also related to regional financial performance, as explained in stewardship theory, which views management as individuals capable of meeting stakeholder needs using their capabilities. This theory can serve as an accountability mechanism for organizations to achieve their goals (Angelina et al., 2020). Stewardship theory has two

components: the owner as the principal and management as the steward. When applied to the government sector, the community acts as the principal and the government as the steward. The community has desires that must be met by the government, namely adequate service facilities, so the government must be able to manage and safeguard regional assets (Angelina et al., 2020).

Regional Financial Performance

Regional financial performance reflects the extent to which a local government is able to independently meet its funding needs. This capability is reflected in the amount of Regional Original Revenue (PAD) collected. The higher the PAD, the stronger the region's fiscal capacity to carry out various governmental duties (Sari and Wijaya, 2024).

Regional Financial Effectiveness Ratio

The PAD effectiveness ratio assesses a local government's ability to achieve its established revenue targets. This indicator is calculated by comparing the amount of PAD realized to the amount of revenue planned in the budget (Fathah, 2017). The formula for the effectiveness ratio is as follows:

$$\text{Regional Financial Effectiveness Ratio} = \frac{\text{Realization of PAD}}{\text{Budget of PAD}} \times 100\%$$

Based on the Decree of the Minister of Home Affairs No. 690.900-327 of 1996. The categories of regional financial effectiveness ratios are as follows:

- 1) $\geq 100\%$ = Very Effective
- 2) 90 – 99% = Effective
- 3) 80 – 89% = Quite Effective
- 4) 60 – 79% = Less Effective
- 5) $< 60\%$ = Ineffective

Regional Financial Efficiency Ratio

The regional financial efficiency ratio (RF) describes the level of a regional government's ability to manage revenue collection costs by comparing expenditures used to generate revenue to the amount of revenue actually generated. This measure provides an overview of the effectiveness of the revenue collection process in relation to the results achieved (Fathah, 2017). A lower ratio indicates that the regional government is able to manage collection costs more efficiently. The formula for calculating the efficiency ratio is as follows:

$$\text{Regional Financial Efficiency Ratio} = \frac{\text{Realization of Regional Spending}}{\text{Realization of Regional Income}} \times 100\%$$

Based on the Decree of the Minister of Home Affairs No. 690.900-327 of 1996, regional financial efficiency is classified as follows:

- 1) $< 60\%$ = Very Efficient
- 2) 60 – 80% = Efficient
- 3) 80 – 90% = Fairly Efficient
- 4) 90 – 100% = Less Efficient
- 5) $> 100\%$ = Inefficient

Empirical Review

Astuti (2015) conducted research in regencies and cities on the island of Java using multiple regression. The results showed that the effectiveness ratio had a positive and significant effect on economic growth. Meanwhile, the efficiency ratio had a positive but insignificant effect on economic growth in regencies/cities on the island of Java.

Siregar (2016) conducted research in Riau Province using multiple linear regression analysis. The results showed that over the past ten years (2006-2015), financial effectiveness had a significant impact on economic growth. Meanwhile, financial efficiency had no effect on economic growth in Riau Province.

Ayu, Rahayu, and Junaidi (2019) conducted research in Jambi Province using path analysis. The results showed that PAD effectiveness and efficiency directly influenced the economic growth of regencies/cities in Jambi Province.

Renggo (2021) conducted research in East Nusa Tenggara Province using multiple regression analysis. The results showed that the effectiveness ratio had no significant effect on economic growth. Meanwhile, the efficiency ratio had a significant effect on economic growth in East Nusa Tenggara Province.

Farhani (2022) conducted research in the regencies/cities of the Special Region of Yogyakarta Province using path analysis. The results showed that the effectiveness ratio and efficiency ratio significantly influenced income inequality in the regencies/cities of the Special Region of Yogyakarta Province.

Fransiska and Hukom (2023) conducted research in Palangka Raya City using panel data regression analysis. The results showed that financial performance significantly influenced income inequality in Palangka Raya City.

2.2 Research Hypothesis and Conceptual Framework

H₁:Regional Financial Effectiveness has a significant positive effect on Economic Growth.

H₂:Regional Financial Efficiency has a significant positive effect on Economic Growth.

H₃:Regional Financial Effectiveness has a significant negative effect on Income Disparity.

H₄:Regional Financial Efficiency has a significant negative effect on Income Disparity.

The hypothesis formulated in this study is:

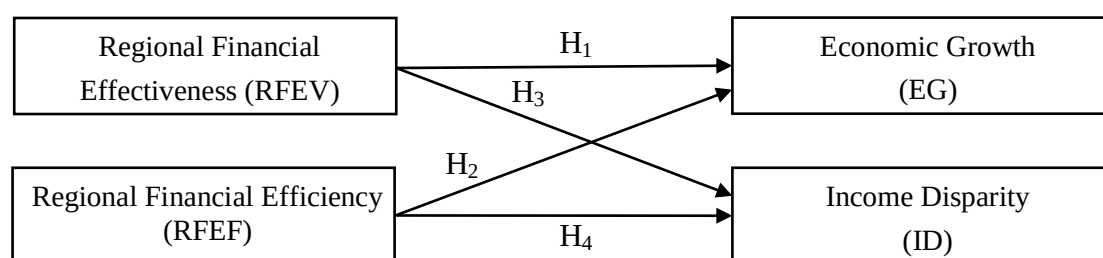


Figure 1. Conceptual Framework

3. Research Method

Form, Place and Time of Research

This research employed quantitative methodology and descriptive analysis, attempting to characterize the phenomenon accurately, methodically, and factually. The study covered all 34 provinces in Indonesia. The study period covered the years 2020 to 2024.

Data Types and Sources

This study uses secondary data obtained from the Directorate General of Fiscal Balance (DJPK), the Ministry of Finance of the Republic of Indonesia (KEMENKEU RI), and the Central Statistics Agency (BPS). Using five years of time series data and cross-sections from 34 provinces, the study yielded a total of 170 observations.

Data Processing Techniques

This study uses multiple regression analysis with panel data, a combination of time series and cross-sectional data. The regression analysis in this study uses two equations:

1. To test the influence of regional financial effectiveness and regional financial efficiency on economic growth, the formula is as follows:

$$EG_{it} = \alpha + \beta_1 RFEV_{it} + \beta_2 RFEF_{it} + e_{it}$$

2. To test the influence of regional financial effectiveness and regional financial efficiency on income disparity, the formula is as follows:

$$ID_{it} = \alpha + \beta_1 RFEV_{it} + \beta_2 RFEF_{it} + e_{it}$$

Information:

EG = Economic Growth

ID = Income Disparity

α = Constanta

$\beta_1 \beta_2$ = Regression Coefficient

RFEV = Regional Financial Effectiveness

RFEF = Regional Financial Efficiency

i = Cross Section

t = Time Series

e = Error Term

Before the data is interpreted, several classical assumption tests are conducted, namely:

1. Multicollinearity Test

The multicollinearity test aims to determine whether there is a perfect relationship between any of the independent variables in the regression model. The presence or absence of multicollinearity can be assessed using the correlation coefficient; if the value is less than 0.08, there is no multicollinearity issue.

2. Heteroskedasticity Test

The heteroscedasticity test aims to determine whether there is inequality in the variance of residuals across observations. One technique used to identify heteroscedasticity involves using a residual plot to examine the distribution of data points along the predicted value and residual axes. The values -500 and 500 indicate the scale limits on the graph's axes.

3. Autocorrelation Test

The autocorrelation test aims to determine whether there is a correlation between the disturbance term in period t and the error in the previous period (t-1) within a linear regression model. The Durbin-Watson statistic can be used to detect the presence of autocorrelation. If the D-W value falls between -2 and 2, it indicates that no autocorrelation is present.

To select the most appropriate model for these two research equations, several stages of econometric testing were conducted, as follows:

1. Chow Test

The test is conducted by comparing two regression models: the Fixed Effect Model (FEM)

and the Common Effect Model (CEM). The decision criteria considered for this test are as follows:

- a) Cross-section chi-square value < 0.05 select the Fixed Effect Model (FEM)
- b) Cross-section chi-square value > 0.05 select the Common Effect Model (CEM)

2. Hausman Test

This test is conducted to determine whether the Fixed Effect Model (FEM) or the Random Effect Model (REM) is appropriate for use. The decision criteria for this test are as follows:

- a) Cross-section chi-square value < 0.05 select Fixed Effect Model (FEM)
- b) Cross-section chi-square value > 0.05 select Random Effect Model (REM)

3. Lagrange Multiplier (LM) Test

The test carried out to compare and find the right model between the Common Effect Model (CEM) and the Random Effect Model (REM), in its implementation there are decision criteria, namely:

- a) Both value < 0.05 select Random Effect Model (REM)
- b) Both value > 0.05 select Common Effect Model (CEM)

4. Result and Discussion

4.1 Result

Testing Equation 1 (Economic Growth)

Table 2. Multicollinearity Test

	Regional Financial Effectiveness (RFEV)	Regional Financial Efficiency (RFEF)
Regional Financial Effectiveness (RFEV)	1,000000	-0,107573
Regional Financial Efficiency (RFEF)	-0,107573	1,000000

Source: EvIEWS 12 Data Processing Results (2025)

Based on the results of the multicollinearity test, none of the correlation coefficients for the variables of regional financial effectiveness and regional financial efficiency exceeded 0.8; therefore, it is concluded that there is no multicollinearity issue.

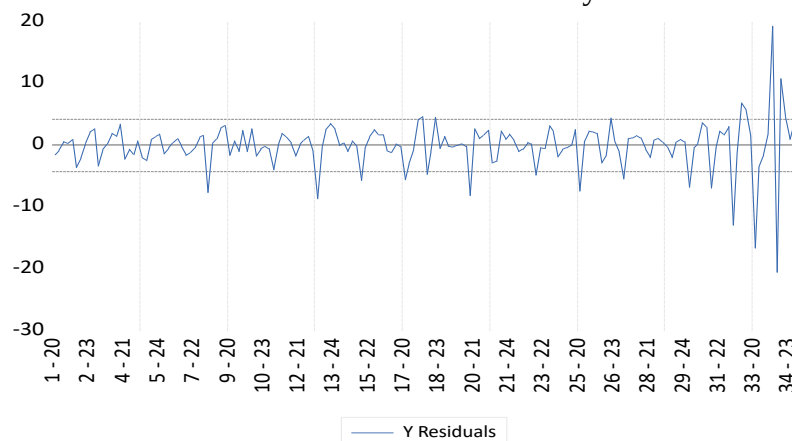


Figure 2. Heteroskedasticity Test

Source: EvIEWS 12 Data Processing Results (2025)

The residual plot shows that the values do not exceed the limits (-500 and 500), indicating that the residual variance is constant. It can be concluded that there is no heteroscedasticity issue.

Table 3. Autocorrelation Test

Durbin-Watson stat	1,380354
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Source: Eviews 12 Data Processing Results (2025)

Based on the autocorrelation test results, a Durbin-Watson value of 1.380354 was obtained; since this value falls within the range of -2 to 2, it can be concluded that there is no autocorrelation problem.

Table 4. Results of the Chow Test, Hausman Test, and Lagrange Multiplier Test

Testing Equipment	Compare	Probability	Decision
Chow	Fixed Effect Model (FEM) with Common Effect Model (CEM)	0,0001	Fixed Effect Model (FEM)
Hausman	Fixed Effect Model (FEM) with Random Effect Model (REM)	0,0034	Fixed Effect Model (FEM)
Lagrange Multiplier	Common Effect Model (CEM) with Random Effect Model (REM)	0,0000	Random Effect Model (REM)

Source: Eviews 12 Data Processing Results (2025)

Based on the results in the table above, the Chow Test probability value of 0.0001 is less than 0.05, indicating that the best model is the Fixed Effect Model (FEM). The Hausman Test probability value of 0.0034 is less than 0.05, indicating that the best model is the Fixed Effect Model (FEM). The Lagrange Multiplier (LM) Test probability value of 0.0000 is less than 0.05, indicating that the best model is the Random Effect Model (REM). Thus, the regression model estimation testing is complete, and it can be concluded that the best model for Equation 1 is the Fixed Effect Model (FEM).

Table 5. Test Results of Equation 1 with Fixed Effect Model (FEM)

Variable Independent	Coefficient	t-Statistic	Prob.	Information
Constanta	0,339305	18,76841	0,0000	-
Regional Financial Effectiveness	0,001035	3,218585	0,0016	Significant
Regional Financial Efficiency	-0,000211	-0,346094	0,7298	No Significant

Source: Eviews 12 Data Processing Results (2025)

Based on the test results, the following equation was obtained:

$$EG_{it} = -4,806268 + 0,001035 RFEV_{it} - 0,000211 RFEF_{it}$$

1. Regional Financial Effectiveness (RFEV)

The t-statistic value is 3,218585 and the probability value is 0,0016, which is less than 0,05. It can be concluded that Regional Financial Effectiveness has a significant and positive effect on Economic Growth.

2. Regional Financial Efficiency (RFEF)

The t-statistic value is -0,346094 and the probability value is 0,7298, which is greater than 0,05. It can be concluded that Regional Financial Efficiency has no significant and

negative effect on Economic Growth.

Testing Equation 2 (Income Disparity)

Table 6. Multicollinearity Test

	Regional Financial Effectiveness (RFEV)	Regional Financial Efficiency (RFEF)
Regional Financial Effectiveness (RFEV)	1,000000	-0,107573
Regional Financial Efficiency (RFEF)	-0,107573	1,000000

Source: Eviews 12 Data Processing Results (2025)

Based on the results of the multicollinearity test, none of the correlation coefficients for the variables of regional financial effectiveness and regional financial efficiency exceeded 0.8; therefore, it is concluded that there is no multicollinearity issue.

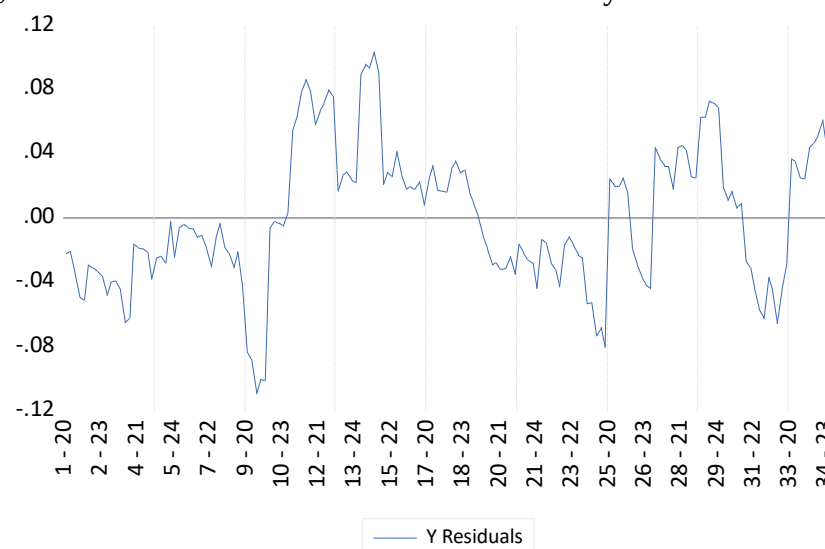


Figure 3. Heteroskedasticity Test

Source: Eviews 12 Data Processing Results (2025)

The residual plot shows that the values do not exceed the limits (-500 and 500), indicating that the residual variance is constant. It can be concluded that there is no heteroscedasticity issue.

Table 7. Autocorrelation Test

Durbin-Watson stat	1,380354
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Source: Eviews 12 Data Processing Results (2025)

Based on the autocorrelation test results, a Durbin-Watson value of 1.380354 was obtained; since this value falls within the range of -2 to 2, it can be concluded that there is no autocorrelation problem.

Table 8. Results of the Chow Test, Hausman Test, and Lagrange Multiplier Test

Testing Equipment	Compare	Probability	Decision
Chow	Fixed Effect Model (FEM) with Common	0,0000	Fixed Effect Model

	Effect Model (CEM)		(FEM)
Hausman	Fixed Effect Model (FEM) with Random Effect Model (REM)	0,9878	Random Effect Model (REM)
Lagrange Multiplier	Common Effect Model (CEM) with Random Effect Model (REM)	0,0000	Random Effect Model (REM)

Source: Eviews 12 Data Processing Results (2025)

The Chow Test probability value of 0.0000 is less than 0.05, indicating that the best model is the Fixed Effect Model (FEM). The Hausman Test probability value of 0.9878 is greater than 0.05, indicating that the best model is the Random Effect Model (REM). The Lagrange Multiplier (LM) Test probability value of 0.0000 is less than 0.05, indicating that the best model is the Random Effect Model (REM). Thus, the regression model estimation testing is complete, and it can be concluded that the best model for Equation 2 is the Random Effect Model (REM).

Table 9. The Result of Equation 2 with Random Effect Model (REM)

Variable Independent	Coefficient	t-Statistic	Prob.	Information
Constanta	0,339305	18,76841	0,0000	-
Regional Financial Effectiveness	1,24E-07	0,167401	0,8673	No Significant
Regional Financial Efficiency	4,32E-07	0,307148	0,7591	No Significant

Source: Eviews 12 Data Processing Results (2025)

Based on the test results, the following equation was obtained:

$$ID_{it} = 0,339305 + 1,24E-07 RFEV_{it} + 4,32E-07 RFEF_{it}$$

1. Regional Financial Effectiveness (RFEV)

The t-statistic value is 0,167401 and the probability value is 0,8673, which is greater than 0,05. It can be concluded that Regional Financial Effectiveness has no significant and positive effect on Income Disparity.

2. Regional Financial Efficiency (RFEF)

The t-statistic value is 0,307148 and the probability value is 0,7591, which is greater than 0,05. It can be concluded that Regional Financial Efficiency has no significant and positive effect on Income Disparity.

The coefficient values of 1.24E-07 for the regional financial effectiveness variable and 4.32E-07 for the regional financial efficiency variable are extremely small; this is due to the difference in measurement scales between the independent and dependent variables. The independent variables (regional financial effectiveness and efficiency) are expressed in nominal Rupiah values—ranging from billions to trillions—resulting in very large independent variable figures and, consequently, small coefficient values. In this study, these variables are measured in percentage terms, meaning a one-unit (100%) increase is relatively large compared to the Gini Index range of only 0 to 1. In contrast, the dependent variable is measured using the Gini Ratio or Williamson Index, which operates on a very narrow scale ranging from 0 to 1.

4.2 Discussion

The Influence of Regional Financial Effectiveness on Economic Growth

Based on the research results obtained in Table 5, it shows that regional financial effectiveness has a positive and significant effect on economic growth in Indonesia. Regional

financial effectiveness has a t-statistic value of 3,218585, indicating a positive or unidirectional relationship between regional financial effectiveness and economic growth. This means that if regional financial effectiveness increases, economic growth will also increase. The probability value of 0,0016 is smaller than the significance level used, which is 0,05, indicating that regional financial effectiveness has a significant effect on economic growth in Indonesia.

The results of this study align with those conducted by Astuti (2015) in regencies and cities on the island of Java, Siregar (2016) in Riau Province, and Ayu, Rahayu, and Junaidi (2019) in Jambi Province, which obtained similar results: regional financial effectiveness had a positive and significant impact on economic growth. This is due to the similarity in research methods and research results obtained. Theoretically, regional financial effectiveness acts as a transmission, the budget as a tool, but effectiveness is the engine. Without an effective engine, no amount of budget will be able to significantly drive economic growth. This study also aligns with the theory put forward by Wallace Oates (1972), namely the theory of fiscal decentralization. Oates stated that regional governments understand the needs of local communities better than the central government. This means that regional financial effectiveness arises from more targeted budget allocation (allocative efficiency). The more effectively a region manages funds according to local needs, the faster economic stimulation occurs in that region.

The provinces with the highest PAD effectiveness in 2024 were East Java, Jakarta, Badung Regency in Bali Province, and East Kalimantan. These provinces consistently recorded high economic growth, with East Kalimantan recording 6,17% growth due to infrastructure development in the Indonesian Capital City (IKN), which had a multiplier effect on the construction, transportation, and trade sectors throughout the province.

Regional financial effectiveness is measured by the extent to which local governments are able to realize revenue targets to fund priority programs. When finances are managed effectively, the budget is not simply spent, but allocated to productive sectors such as road and bridge construction, which reduces logistics costs, education and health, which improve the quality of human capital, in the long term, boosting national productivity. The Special Allocation Fund (DAK) ensures that regions have funds for physical development that has a direct impact on the economy. Financial effectiveness means reducing budget leakage, so that every Rupiah provides maximum benefits to the public through bureaucratic efficiency mechanisms. Despite its positive impact, this effectiveness is highly dependent on the quality of spending (better spending). If the budget is only spent on employee expenses (bureaucratic salaries) without infrastructure development, its significant impact on economic growth can be hampered.

This research disagrees with research conducted by Renggo (2021) in East Nusa Tenggara Province, which found that regional financial effectiveness had no significant impact on economic growth. This is due to differences in research years and regions.

The Influence of Regional Financial Efficiency on Economic Growth

Based on the research results obtained in Table 5, it shows that regional financial efficiency has a negative and insignificant effect on economic growth in Indonesia. Regional financial efficiency has a t-statistic value of -0,346094, which indicates a negative or inverse relationship between regional financial effectiveness and economic growth. This means that if regional financial efficiency increases, economic growth will decrease, and vice versa, if regional financial efficiency decreases, economic growth will increase. However, the

probability value of 0,7298 is greater than the significance level used, namely 0,05, meaning that regional financial efficiency does not have a significant effect on economic growth in Indonesia.

The results of this study align with those conducted by Siregar (2016) in Riau Province and Astuti (2015) in regencies and cities on Java Island, which obtained similar results: regional financial efficiency had no significant impact on economic growth. This is due to the similarity in research methods and results. Theoretically, an efficient budget should drive growth. However, in many cases in regions, efficiency has not had a significant impact. During the pandemic, the focus of regional finances shifted completely from economic development to health care and social safety nets. Regional governments were very efficient in refocusing their budgets, but these funds were used for survival-oriented social assistance and health care, rather than for productive investments that drive economic growth.

Budget efficiency is often measured by how prudently local governments utilize their allocated spending limits. However, regional budgets in Indonesia remain dominated by personnel costs and expenditures on goods and services—accounting for as much as 50% to 70% of the total in some regencies and cities. Even if these routine expenditures are managed with high efficiency—free from excess unspent funds or waste—they drive only short-term consumption rather than the gross fixed capital formation (investment) needed to foster sustainable economic growth.

Capital expenditure—such as the construction of roads, bridges, ports, and irrigation networks—represents the component of the regional budget (APBD) with the highest multiplier effect on the Gross Regional Domestic Product (GRDP). However, since capital expenditure typically accounts for only 10%–18% of the total regional budget, efficiencies achieved within this limited share are insufficient to drive the engine of regional economic growth in the aggregate. Regions deemed "efficient" due to cost-cutting measures often experience delays in program execution. The concentration of budget disbursements at the end of the year (the fourth quarter) or excessive cost-saving measures results in a high budget surplus (SiLPA). Regional budget funds that remain idle in bank accounts fail to circulate within the community, thereby stifling the pace of regional economic growth.

The economies of most regions in Indonesia are primarily driven by household consumption, private investment, and key commodities (such as agriculture, mining, or manufacturing). The contribution of regional budgets (APBD) to total regional GDP (PDRB) is generally small—often below 10%–15%—meaning that the efficiency of local government fiscal management has only a marginal impact on overall regional GDP growth rates.

Regional financial efficiency measures only how frugally or disciplinedly local governments spend their budgets, not the magnitude of the economic impact generated. Given that the regional budget (APBD) represents a small share of the Gross Regional Domestic Product (PDRB) and is largely consumed by routine expenditures, budgetary efficiency is not a primary determinant of economic growth.

The results of this study are inconsistent with those conducted by Ayu, Rahayu, and Junaidi (2019) in Jambi Province and Renggo (2021) in East Nusa Tenggara Province, which found that regional financial efficiency significantly impacts economic growth. This is due to differences in the research years and research regions.

The Influence of Regional Financial Effectiveness on Income Disparity

Based on the research results obtained in Table 9, it shows that regional financial effectiveness has a positive but insignificant effect on income disparity in Indonesia.

Regional financial effectiveness has a t-statistic value of 0,167401, indicating a positive or unidirectional relationship between regional financial effectiveness and income disparity. This means that if regional financial effectiveness increases, income disparity will also increase. However, the probability value of 0,8673 is greater than the significance level used, namely 0,05, indicating that regional financial effectiveness does not have a significant effect on income disparity in Indonesia.

The results of this study align with research conducted by Farhani (2022) in the regencies/cities of Yogyakarta Province, which found similar results: regional financial effectiveness had no significant effect on income disparity. This is due to the similarity in research methods and results. Theoretically, an effective budget should be an instrument for wealth redistribution. However, in reality, regional financial effectiveness often fails to reduce income disparity, namely the gap between rich and poor.

Effectiveness is often measured solely by budget absorption or revenue targets achieved. However, this effectiveness does not always take into account the quality of spending. In fact, many regional budgets are effectively utilized, but the allocation is primarily to large-scale physical infrastructure or projects benefiting the upper middle class, rather than to programs that directly impact the lowest levels of society. Even if regional governments effectively allocate education funds, the results are not immediate. Income inequality in Indonesia is heavily influenced by differences in job skills. If regional financial effectiveness only builds schools but fails to improve teacher quality and curriculum relevance to the job market, graduates will still struggle to secure high salaries. Consequently, the income gap remains wide.

In regions with high financial efficiency, such as mining or industrial areas, economic growth is typically capital-intensive, relying on machinery and technology. Economic benefits are enjoyed by only a handful of capital owners or skilled workers from outside the region, while local communities not absorbed by these industries remain in poverty. Regional fiscal effectiveness is unable to intervene in this market mechanism. One instrument to reduce disparities is social assistance and subsidies. Even when budgets are provided effectively, exclusion and inclusion errors often occur in recipient data. If aid is not properly targeted, income distribution will not shift, thus insignificantly reducing the inequality index (Gini Ratio).

Regional financial effectiveness is often concentrated in urban areas (urban bias). Infrastructure development and public services in city centers are more effectively managed than in hard-to-reach rural areas. This actually widens the income disparity between rural and urban residents within the same province. West Java Province is categorized as highly effective because budget absorption and local revenue consistently exceed targets, yet it has one of the highest disparities in Indonesia. This means that the budget is effectively used to build factories and malls, but low-wage workers are concentrated in urban areas, resulting in a widening gap with the economic elite or upper class. Papua Province is categorized as effective because it is supported by very large and massively absorbed Special Autonomy funds. Like West Java, Papua is also a region with very high inequality due to the stark contrast between Jayapura and the mountainous region. This results in regional financial effectiveness not having a significant impact on income disparity because funds are absorbed for physical infrastructure, but access to economic opportunities remains limited for communities in remote areas.

Current regional financial effectiveness focuses more on administrative efficiency and physical development, but remains very weak in terms of distributive justice. As long as the

regional budget (APBD) fails to create inclusive employment, no matter how high the financial efficiency rate, it will be difficult to significantly reduce inequality. This study's findings align with Fransiska and Hukom (2023) study in Palangka Raya City, which found that regional financial effectiveness significantly impacts income disparity. This difference is due to differences in the research year and research region.

The Influence of Regional Financial Efficiency on Income Disparity

Based on the research results obtained in Table 9, it shows that regional financial efficiency has a positive but insignificant effect on income disparity in Indonesia. Regional financial efficiency has a t-statistic value of 0,307148, indicating a positive or unidirectional relationship between regional financial efficiency and income disparity. This means that if regional financial efficiency increases, income disparity will also increase. However, the probability value of 0,7591 is greater than the significance level used, namely 0,05, indicating that regional financial efficiency does not have a significant effect on income disparity in Indonesia.

The results of this study align with research conducted by Farhani (2022) in the regencies/cities of Yogyakarta Province, which found similar results: regional financial efficiency had no significant effect on income disparity. This is due to the similarity in research methods and results. Theoretically, efficiency in doing things at the lowest possible cost should leave budgetary space for equity programs. However, in Indonesia, regional financial efficiency often has no significant effect on income disparity due to several structural factors. Local governments often become trapped in administrative efficiencies such as saving paper, business travel, or reducing office operating costs. These savings may appear good from an accounting perspective, but they are too small to change the economic structure. What is needed to reduce disparity is allocative efficiency, namely the ability to divert funds from non-productive sectors to labor-intensive sectors for the poor. As long as budget allocations remain biased toward urban projects, disparity will remain unchanged.

Many regions are efficient in attracting investment and managing finances for large infrastructure projects such as toll roads or industrial estates. However, these investments are often capital-intensive because they use machines, not labor-intensive human labor. Consequently, economic growth is enjoyed only by capital owners and skilled workers, while lower-income communities remain left behind. Fiscal efficiency in supporting these industries actually widens the income gap. Efficiency in social assistance budgets is often interpreted as spending the available budget, yet the challenge is often inaccurate poverty data. If the budget is managed efficiently but misdirected, for example, by excluding the wealthy from receiving subsidies/assistance, the money will not reduce inequality. Efficiency without accurate data will only maintain the status quo of inequality.

In Indonesia, financial efficiency tends to be easier to achieve in developed regions like Java and major cities because their infrastructure and bureaucratic systems are already in place. This creates a "backwash effect," where capital and skilled labor are drawn to these developed regions. Remote regions with inefficient bureaucracies are increasingly left behind. Efficiency in these growth centers actually exacerbates income disparities between regions. The majority of poor people in Indonesia work in the informal sector, such as street vendors and small farmers. Regional financial efficiency typically focuses on the formal sector, which is easily taxed and measured. As long as regional budgets do not address the massive productivity gains in the informal sector, fiscal efficiency will never address the root causes of income inequality. Financial efficiency is about how to manage finances, while

reducing disparities is about budgetary political bias. If money is managed very efficiently but does not favor the marginalized, inequality will remain high.

The results of this study are inconsistent with research conducted by Fransiska and Hukom (2023) in Palangka Raya City, which found that regional financial efficiency significantly impacts income disparity. This difference is due to differences in the research year and research region.

5. Conclusion

Regional financial effectiveness has a positive and significant impact on economic growth in Indonesia. This is because such effectiveness is measured by the extent to which local governments succeed in meeting revenue targets to fund priority programs. Conversely, regional financial efficiency has a negative and insignificant impact on economic growth in Indonesia; efficiency at the administrative level proves insufficient to counteract the decline in household consumption and sluggish private investment caused by global uncertainty. Furthermore, efficiency in budget absorption is often achieved only at the end of the fiscal year, leading to disruptions in global supply chains.

Regional financial effectiveness has a positive but statistically insignificant impact on income disparity in Indonesia. This is because current regional financial effectiveness focuses largely on administrative efficiency and physical infrastructure development while remaining weak regarding distributive justice. As long as regional budgets fail to generate inclusive employment, no level of financial efficiency—however high—will suffice to significantly reduce inequality. Regional financial efficiency has a positive but statistically insignificant impact on income disparity in Indonesia. This is because, unless regional budgets aggressively bolster productivity within the informal sector, fiscal efficiency will never address the root causes of income inequality. Financial efficiency concerns the management of funds, whereas reducing disparity is a matter of the political orientation of the budget; if funds are managed with great efficiency but without prioritizing the marginalized, inequality will remain high.

Recommendation

The government must view effectiveness not only as measured by budget absorption, but also by outcomes. For example, the allocated budget should not be assessed solely by the amount distributed, but also by the percentage increase in those results. Efficiency often fails to impact economic growth because it is applied evenly across all sectors without considering regional economic potential (flat-cutting). The government can implement an asymmetric efficiency strategy. Strict efficiency is implemented in the bureaucracy, but incentives and budget allocations are increased in leading sectors, such as tourism in Bali or industry in West Java.

The government is increasing spending allocations for microeconomic empowerment programs, collateral-free business capital assistance for the poor, and integrated social protection. This ensures that effectively managed funds go directly to the pockets of the grassroots, rather than simply circulating among large businesses that win infrastructure projects. Efficiency in cutting bureaucratic operational costs must be accompanied by significant investment in basic services in areas of poverty. The government can divert savings (efficiencies) from routine budgets to finance vocational scholarships for children from low-income families and access to free, quality healthcare in remote areas. If human resources are evenly distributed, citizens' ability to earn income will also be more equal.

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