

Analysis of Regional Financial Performance Ratios on Economic Growth in the Fiscal Decentralization Era in the Bakorwil II Region of East Java Province

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ABSTRACT

Regional governments have more power to oversee public finances and promote regional economic growth because to fiscal decentralization. The purpose of this study is to investigate how regional financial performance ratios affect economic growth in East Java Province's Bakorwil II region between 2015 and 2024. Using panel data from regional financial reports and the Central Bureau of Statistics, the study takes a quantitative approach and covers seven regencies and one municipality. EViews was used to do panel data regression analysis, and the Chow, Hausman, and Lagrange Multiplier tests were used to pick the model. The findings suggest that the activity ratio has a positive and substantial impact on economic growth, the effectiveness ratio has a negative and significant association, and the financial independence ratio has a positive but minor influence. These results emphasize the significance of public spending focused on development in fostering regional economic expansion.

INTRODUCTION

In many developing nations, fiscal decentralization has emerged as a key strategy to improve public service delivery and regional economic performance. Following the 1998 financial crisis, Indonesia implemented a fiscal decentralization reform that significantly altered the country's governance structure by transferring a sizable amount of fiscal authority from the central government to regional governments. This reform gave local governments more freedom to allocate funds and choose development objectives according to local circumstances. According to (Mega Christia & Ispriyarso, 2019) and (Oates et al., 2006), this policy framework seeks to increase the effectiveness of the distribution of public resources, bolster local accountability, and eventually encourage regional economic growth. Regional governments can better leverage local economic potential and create policies that better represent the interests and preferences of their people thanks to fiscal decentralization.

Law No. 32 of 2004 about regional governance and Law No. 33 of 2004 concerned fiscal balance between central and regional governments are two of the legal frameworks that formally control fiscal decentralization in Indonesia. The Regional Revenue and Expenditure Budget (APBD), which local governments use to manage their own budgets, is established by these regulations. By maximizing Local Own-Source Revenue (PAD) and efficiently controlling regional expenditures, local governments are encouraged to expand their fiscal capacity under this approach. As a key measure of budgetary autonomy, PAD shows how well regional governments can fund development initiatives on their own (Astika et al., 2022; Yakub et al., 2022). Greater flexibility in allocating resources to productive sectors that boost economic growth is typically found in regions with superior fiscal capacity.

However, the quality of financial administration is just as important to the success of fiscal decentralization as the amount of regional revenue. Whether fiscal decentralization may provide favorable economic results depends critically on the efficacy and efficiency of public spending. In actuality, regional differences in fiscal capacity continue to be a significant problem in Indonesia. Local governments frequently have uneven budgetary performance due to differences in economic structure, administrative capacity, and potential for local resources. Therefore, how well local governments manage their financial resources can have a big impact on regional economic growth ((Salma Nazikha & Rahmawati, 2021a).

In this sense, assessing regional financial performance is crucial to comprehending the efficacy of fiscal decentralization initiatives. Financial ratio analysis is a popular method for evaluating financial performance. The financial independence ratio, the effectiveness ratio, and the activity ratio are a few of the metrics that are frequently employed to assess the caliber of regional financial management. The ability of a region to support its expenditures with locally generated revenue, hence minimizing dependency on central government transfers, is shown in the financial independence ratio. In the meantime, the activity ratio shows the percentage of capital spending allotted for productive development activities, and the effectiveness ratio assesses the capacity of local

governments to attain planned revenue collection. According to (Rokhim et al., n.d.), these financial ratios are crucial indications of how local governments handle fiscal resources to support regional economic development.

Endogenous growth theory, which highlights the significance of public investment and government policy in promoting economic development, provides a theoretical explanation for the relationship between fiscal success and economic growth. Productive government spending, especially in public services and infrastructure, can boost economic productivity and produce long-term economic growth, according to Barro (1990). Local governments are crucial in directing funds toward projects that boost regional economic potential within the framework of fiscal decentralization. Therefore, whether fiscal decentralization can improve regional economic performance depends critically on effective financial management (Chandra & Badrudin, 2024).

The Armeij Curve, which explains the nonlinear link between government spending and economic growth, is another pertinent theoretical viewpoint. According to the notion, public spending first promotes economic growth by building infrastructure and providing public services. But over a certain point, excessive government expenditure can lead to fiscal inefficiencies or resource misallocation, which can impede economic growth and diminish economic efficiency. Therefore, the efficiency and productivity of fiscal allocation are more important than just the amount of money spent by the government.

Fiscal decentralization is a key factor in determining regional development in East Java Province, one of Indonesia's most economically vibrant areas. The province is made up of various economic regions with different economic structures and budgetary capacities. Because of its diverse economic features and differing fiscal capacities among districts and municipalities, the Bakorwil II region stands out among these locations as an intriguing subject for examination. Each of the region's cities Bojonegoro, Lamongan, Tuban, Jombang, Mojokerto, Gresik, Nganjuk, and Mojokerto City has a unique economic structure that ranges from manufacturing and industry to agriculture and energy-based industries. Local governments' regional fiscal performance and economic growth patterns vary as a result of this variability (Anugerah & Nuraini, 2021).

The Bakorwil II region's districts have significantly different rates of economic growth, according to empirical data. Mojokerto Regency, for instance, saw economic development of 5.29%, followed by Jombang at 5.15% and Lamongan at 4.81%, demonstrating significant contributions from the trade and industrial sectors. Bojonegoro, on the other hand, saw much slower growth at about 1.67%, which might be explained by its reliance on the erratic extractive sectors. These disparities show that regional economic performance can be impacted by variances in fiscal management and economic structures. As a result, it becomes crucial to examine financial performance ratios in order to comprehend how fiscal management supports regional economic growth (BPS, 2024).

The significance of regional fiscal performance in impacting economic growth has been emphasized by earlier empirical research. For example, studies

carried out in several Indonesian provinces indicate that intergovernmental transfers and local revenue sources have a major impact on regional economic performance (Shofiul et al., 2022). According to additional research, promoting local fiscal independence and boosting development financing are two ways that increases in PAD and fiscal management capacity support regional economic growth ((Marsudi et al., n.d.); (Tajuddin & Kessi, 2025)). However, due to regional variations in fiscal capacity, governance quality, and economic structures, the relationship between financial performance ratios and economic growth is still context-dependent.

Even though fiscal decentralization in Indonesia has been extensively studied, the majority of these studies concentrate on provincial-level analysis or general regional comparisons. The relationship between regional financial performance ratios and economic growth in East Java's Bakorwil administrative regions has not been thoroughly studied. More empirical research is required to comprehend how financial management performance affects regional economic growth given the Bakorwil II region's heterogeneity in fiscal capacity and economic structure.

Given this context, the purpose of this study is to investigate the connection between regional financial performance ratios and economic growth in the East Java Province's Bakorwil II region from 2015 to 2024. In particular, the study looks into how, within the framework of fiscal decentralization, the financial independence ratio, effectiveness ratio, and activity ratio affect regional economic growth. This study adds to the body of knowledge on fiscal decentralization by examining a heterogeneous regional cluster and offering actual data on how regional economic performance is impacted by differences in local fiscal management.

THEORETICAL REVIEW

Fiscal Decentralization Theory

The transfer of fiscal authority from the federal government to local governments for the purpose of managing public finances and setting spending priorities in accordance with local demands is known as fiscal decentralization. This idea seeks to increase local responsibility and optimize the use of public resources. Fiscal decentralization, according to (Oates et al., 2006), enables local governments to deliver public services more effectively since they have better knowledge of regional traits and local preferences. Similarly, by moving decision-making processes closer to local communities, decentralization can increase public engagement and speed regional development (Rondinelli, 1981).

Law No. 33 of 2004 establishing fiscal balance between the central government and regional governments established fiscal decentralization in Indonesia. This policy grants regional governments the power to oversee financial resources via the Regional Revenue and Expenditure Budget (APBD). While preserving effective and efficient public spending management, this approach pushes regions to maximize local revenue streams. As a result, fiscal decentralization becomes an essential tool for boosting regional fiscal capacity and encouraging long-term economic growth.

The connection between fiscal decentralization and economic success has been the subject of numerous empirical investigations. Local revenue and intergovernmental transfers have a major impact on regional economic growth, according to research done in several Indonesian regions (Shofiul et al., 2022). In a similar vein, research suggests that more fiscal autonomy helps regional governments allocate development funds more effectively, which enhances regional economic performance (Marsudi, 2019). However, other research indicates that when public spending is inefficient or financial management ability is still restricted, fiscal decentralization does not necessarily have favorable results (Adipura et al., n.d.).

Fiscal decentralization is anticipated to impact economic growth through regional financial management performance, especially through metrics like financial independence, efficacy, and activity ratios, based on this theoretical and empirical foundation.

H1: Regional economic growth is positively impacted by the regional financial independence ratio.

Regional Financial Performance Theory

The ability of local governments to effectively and efficiently manage financial resources in order to achieve development goals is referred to as regional financial performance. Financial ratio analysis is frequently used to assess performance in the context of public sector financial management. Financial ratios are crucial tools for assessing the fiscal performance and financial health of regional governments, according to. These ratios aid in evaluating the efficiency with which local governments raise money, distribute spending, and preserve budgetary viability.

When assessing regional financial performance, three primary financial ratios are frequently utilized. First, the financial independence ratio indicates the degree of fiscal autonomy by calculating the percentage of local own-source income (PAD) in relation to total regional revenue. Higher independence ratios provide regions more freedom to choose their own development goals and often depend less on transfers from the federal government. Second, the effectiveness ratio assesses how well regional governments are able to meet budgetary revenue goals. Strong financial management and precise revenue planning are indicative of high effectiveness. Third, the activity ratio illustrates the government's dedication to public investment and development-oriented spending by calculating the percentage of capital expenditure in relation to total regional expenditure.

Strong regional financial performance has a good impact on regional economic development, according to empirical research. For example, studies reveal that improved fiscal management and higher PAD boost economic growth by allowing governments to spend in public services and infrastructure (Yakub et al., 2022). Additionally, research shows that greater capital expenditure allocations frequently promote regional economic growth by boosting investment and raising productivity (Salma Nazikha & Rahmawati, 2021b).

However, some studies argue that fiscal performance indicators do not always guarantee economic growth if government spending is not allocated productively. The potential economic impact of fiscal decentralization may be diminished by inefficient spending or an over-reliance on transfers from the central government (Salma Nazikha & Rahmawati, 2021). The following theory is put forward in light of these theoretical justifications and actual data:

H2: Regional economic growth is positively impacted by the regional financial effectiveness ratio.

H3: Regional economic growth is positively impacted by the regional financial activity ratio.

Conceptual Framework

According to regional financial performance theory and fiscal decentralization theory, local governments' capacity to efficiently manage their financial resources has an impact on regional economic growth. Regional governments with fiscal autonomy are able to raise money, distribute spending, and make investments in profitable industries that boost the economy.

The ability of regional governments to fund development using locally produced income is reflected in the financial independence ratio. Stronger local economic capability and more development planning flexibility are associated with higher budgetary independence. The government's capacity to maximize fiscal resources and meet revenue targets is reflected in the effectiveness ratio. In the meantime, the activity ratio, which calculates the percentage of capital expenditure, shows how much of government spending goes toward profitable ventures like infrastructure construction.

Since efficient fiscal management encourages investment, boosts productivity, and enhances regional economic competitiveness, these financial performance metrics taken together have an impact on regional economic growth. Thus, the following conceptual framework can be used to explain the connection between regional financial success and economic growth.

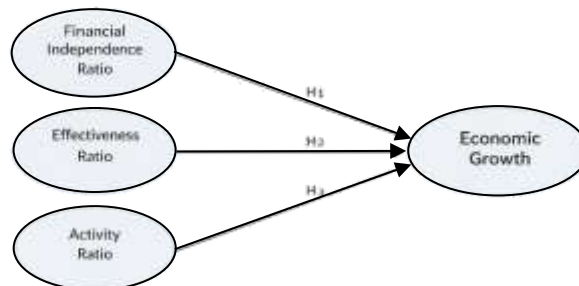


Figure 1. Conceptual Framework

METHODOLOGY

In order to investigate the connection between regional financial performance ratios and economic growth in the Bakorwil II region of East Java Province, this study uses a quantitative research methodology. The study makes

use of secondary data from regional government budget reports and Central Bureau of Statistics (BPS) official publications. The panel data, which combines cross-sectional and time-series observations, spans the years 2015 to 2024.

The Bakorwil II administrative region of East Java Province's regencies and municipalities comprise the study's population. Bojonegoro Regency, Lamongan Regency, Tuban Regency, Jombang Regency, Mojokerto Regency, Gresik Regency, Nganjuk Regency, and Mojokerto City are the seven regencies and one municipality that make up the research sample. These areas were chosen due to their varied economic structures and fiscal capacities, as well as their representation of the administrative entities within the Bakorwil II coordinating area.

Three independent factors and one dependent variable were included in this study. Regional economic growth, as determined by the Gross Regional Domestic Product (GRDP) growth rate, is the dependent variable. The financial independence ratio, the effectiveness ratio, and the activity ratio of regional financial management are examples of independent variables. The percentage of local own-source revenue in relation to total regional revenue is represented by the financial independence ratio. The effectiveness ratio evaluates regional governments' capacity to meet revenue goals outlined in the regional budget. In the meantime, the percentage of capital spending in relation to overall regional expenditure is represented by the activity ratio. Panel data regression techniques are used in this study's data analysis. Because panel regression integrates cross-sectional and time-series data, it enables a more thorough examination of regional and temporal differences. Several model selection procedures, such as the Chow, Hausman, and Lagrange Multiplier (LM) tests, are used to identify the best regression model. These tests are used to determine which of the Common Effect Model, Fixed Effect Model, and Random Effect Model is the best estimation model.

Make sure the regression findings are reliable, classical assumption tests are carried out after the right model has been identified. These tests include autocorrelation, heteroskedasticity, and multicollinearity tests. The t-test is used in hypothesis testing to ascertain the importance of each independent variable on economic growth, and the coefficient of determination (R^2) is used to assess the regression model's overall explanatory capacity. By using these analytical techniques, the study seeks to present actual data about how regional financial performance ratios affect economic growth in the Bakorwil II region within the framework of fiscal decentralization.

RESULTS

The empirical results of the study investigating the impact of regional financial performance ratios on economic growth in the Bakorwil II region of East Java Province between 2015 and 2024 are presented in this section. EViews version 12 was used to do panel data regression analysis. Panel data model selection tests, regression estimation, classical assumption tests, and hypothesis testing are some of the steps in the analytical process. The following sections provide a detailed explanation of each stage of the statistical analysis.

Panel Data Model Selection

Before estimating the regression model, several tests were conducted to determine the most appropriate panel data model. These tests include the Chow test, Hausman test, and Lagrange Multiplier test.

Chow Test

The Chow test is conducted to determine whether the Common Effect Model (CEM) or the Fixed Effect Model (FEM) is more appropriate.

Table 1. Chow Test Results

Effect Test	Statistic	d.f.	Prob.
Cross section F	0.851794	(6.60)	0.5355
Cross section Chi-square	5.722.172	6	0.4550

Source: Eviews Version 12.2023 (processed data)

According to the findings, the cross-section F statistic's probability value is 0.5355, which is higher than the significance level of 0.05. This suggests that the Common Effect Model is more suitable than the Fixed Effect Model because there is no discernible variation between the intercepts across cross-sectional units. Nevertheless, even though the Chow test shows that the Common Effect Model is appropriate, the ultimate model selection cannot be made solely by this test. Therefore, additional testing is needed to compare different methods for estimating panel data.

Hausman Test

The Hausman test is conducted to determine whether the Random Effect Model (REM) or the Fixed Effect Model (FEM) is more appropriate.

Table 2. Hausman Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq.d.f.	Prob.
Cross-Section random	4.680.267	3	0.1968

Source: Eviews Version 12.2023 (processed data)

The probability value of 0.1968 in the Hausman test result is higher than the significance level of 0.05. This suggests that the Fixed Effect Model is not as good as the Random Effect Model. However, the findings of the Hausman and Chow tests offer distinct suggestions for the best panel data model. The Hausman test reveals the Random Effect Model, whereas the Chow test proposes the Common Effect Model. In order to identify the best model, the Lagrange Multiplier test is necessary.

Lagrange Multiplier Test

The Lagrange Multiplier (LM) test is used to determine whether the Common Effect Model or Random Effect Model is more appropriate.

Table 3. Lagrange Multiplier Test Results

	Cross-section	Test Hypotesis Time	Both.
Breusch-Pagan	1.349594 (0.2453)	120.0161 (0.0000)	121.3657 (0.000)

Source: Eviews Version 12.2023 (processed data)

The probability value of the Breusch–Pagan cross-section statistic is 0.2453, which is greater than the significance level of 0.05. This indicates that the Common Effect Model is more appropriate than the Random Effect Model.

Summary of Model Selection

Table 4. Panel Data Model Selection

Test	Result	Decision
Chow Test	Prob > 0.05	Common Effect Model
Hausman Test	Prob > 0.05	Random Effect Model
Lagrange Multiplier Test	Prob > 0.05	Common Effect Model

Source: Eviews Version 12.2023 (processed data)

The Common Effect Model (CEM) is chosen as the best model for estimating the regression equation in this investigation based on the overall outcomes of the model selection tests. The intercept and slope coefficients are assumed to be constant across cross-sectional units and time periods in this model.

Panel Regression Estimation

The Common Effect Model was used in the regression analysis to determine the impact of regional financial performance ratios on economic growth after the proper model had been chosen.

Table 5. Common Effect Model Estimation

Variabel	Koefisien Regresi
C	1.137207
Rasio Kemandirian (X1)	5.341314
Rasio Efektivitas (X2)	-1.91E-14
Rasio Aktivitas (X3)	1.110543
R-squared = 0.128538 Adjusted R-squared = 0.088926 Prob (F-statistic) = 0.02738 Durbin-Watson stat = 2.151880 Variabel Terkat = Pertumbuhan Ekonomi	

Source: Eviews Version 12.2023 (processed data)

The regression equation can be expressed as follows:

$$Y = 1.13720721896 + 5.341314 - 1.91E-14 + 11.10543 + e$$

The constant coefficient of 1.137207 shows that economic growth will rise by roughly 1.137 percent when all independent factors stay the same. An rise in fiscal independence tends to boost economic growth, according to the coefficient of the financial independence ratio (5.341314). Although the extent of the influence depends on the efficiency of fiscal administration, this positive coefficient indicates that increased contributions of locally generated money may enhance regional economic performance.

Revenue effectiveness and economic growth are negatively correlated, according to the effectiveness ratio coefficient (-1.91E-14). It implies that increases in revenue realization do not always lead to greater economic growth, despite the coefficient value being somewhat low. The allocation of development expenditures and economic growth are positively correlated, according to the activity ratio coefficient (1.110543). This finding implies that better regional economic performance may be a result of higher government spending on development initiatives.

Classical Assumption Tests

A number of diagnostic tests were carried out to make sure the regression model follows the traditional econometric assumptions.

Table 6. Multicollinearity Test Results

	X1	X2	X3
X1	1,000000	0,557542	-0,374194
X2	0,557542	1,000000	-0,130846
X3	-0,374194	-0,130846	1,000000

Source: Eviews Version 12.2023 (processed data)

The regression model does not have multicollinearity issues because all of the correlation coefficients between the independent variables are less than 0.85. This implies that any independent variable can be added to the regression model concurrently and offers unique information.

Heteroskedasticity Test

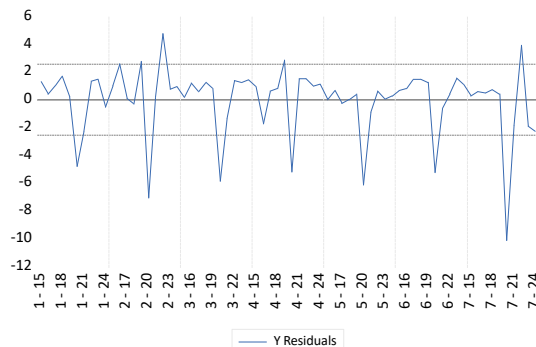


Figure 2. Heteroscedasticity Residual Plot
Source: Eviews Version 12.2023 (processed data)

Remaining graphical analysis was used to perform the heteroskedasticity test. The residual distribution stays between -500 and 500, suggesting that the residuals' variance doesn't change between observations. As a result, there are no heteroskedasticity issues with the regression model.

Autocorrelation Test

The Durbin-Watson statistic was used to perform the autocorrelation test. The resultant Durbin-Watson value is 2.151880. The lower limit value is 1.73 and the upper bound value is 2.17 based on the Durbin-Watson table with K = 5 and N = 60. There are no autocorrelation issues with the regression model because the Durbin-Watson value is within this range.

Hypothesis Testing

Coefficient of Determination (R²)

The financial independence ratio, effectiveness ratio, and activity ratio account for around 12% of the variation in economic growth, according to the coefficient of determination value of 0.128538. In the meantime, factors including investment, industrial development, labor productivity, and other regional economic variables that are not part of the regression model account for 88% of the variation in economic growth.

F-Test

To ascertain if the independent variables collectively affect economic growth, the F-test is used. The F-statistic's probability value of 0.02738 is less than the significance level of 0.05. This suggests that the Bakorwil II region's economic growth is concurrently influenced by the financial independence ratio, effectiveness ratio, and activity ratio.

Table 7. t-Test Results

Variabel	T-hitung	T-tabel	Sig
Rasio Kemandirian (X1)	1,854432	1,99656	0,0681
Rasio Efektivitas (X2)	-2,498358	1,99656	0,0150
Rasio Aktivitas (X3)	2,106560	1,99656	0,0390

Source: Eviews Version 12.2023 (processed data)

Because the significance value of 0.0681 is higher than the significance level of 0.05, the financial independence ratio has a positive but statistically negligible impact on economic growth. Because the significance value of 0.0150 is less than the significance level of 0.05, the effectiveness ratio shows a negative and statistically significant impact on economic growth. Because the significance value of 0.0390 is less than the 0.05 significance level, the activity ratio demonstrates a positive and statistically significant impact on economic growth.

DISCUSSION

The empirical results about the connection between regional financial performance and economic growth in the Bakorwil II region of East Java Province are covered in this part. The research findings are interpreted through theoretical lenses and contrasted with earlier empirical research in the areas of regional economic development and fiscal decentralization.

Financial Independence Ratio and Economic Growth

The study's conclusions show that the Bakorwil II region's regional economic growth is not greatly impacted by the financial independence ratio. The findings indicate that while there is a positive correlation between fiscal independence and economic growth, increases in fiscal autonomy do not always lead to economic growth.

Fiscal independence, as seen through the lens of fiscal decentralization theory, is the ability of local governments to support development initiatives using locally generated revenue instead of largely depending on intergovernmental payments. Decentralization, according to (Oates et al., 2006), enables local governments to distribute public resources more effectively since they have greater knowledge of the requirements and possibilities of the local economy.

Theoretically, local governments should be able to boost development spending in profitable areas like infrastructure, education, and economic development initiatives with increased fiscal independence. It is anticipated that these investments will boost local economic activity and enhance overall economic performance. Nevertheless, the study's empirical results show that fiscal independence by itself does not ensure economic expansion. The endogenous growth theory, which contends that government fiscal capacity can promote economic growth through profitable public investment, is not entirely supported by this conclusion.

The Bakorwil II region's regional economic structure is one potential explanation. Natural resource industries like fishing, agriculture, and oil and gas extraction are important to a number of districts. Rather than regional fiscal strategies, external factors like global commodity pricing and market circumstances have a greater impact on economic performance in these industries. This behavior can also be explained by agency theory. Local governments manage public resources as agents in a decentralized fiscal system. However, poor budget allocation or opportunistic fiscal management practices may result from information asymmetry between the national and local governments (Fama, 1980). Therefore, greater fiscal independence may not always result in beneficial public spending that promotes economic expansion.

The Armey Curve idea is another theoretical viewpoint that contributes to the explanation of these results. According to this idea, there is a non-linear relationship between the size of the government and economic growth. Early on, higher government investment can boost economic expansion by enhancing public services and infrastructure. However, excessive government interference may lower economic efficiency over a certain point because of higher bureaucratic expenses and wasteful public spending .

The results of this study are in line with a number of earlier studies that also show that regional economic growth is not usually significantly impacted by fiscal independence. For instance, (Ramadhani, 2019) discovered comparable outcomes in Indonesia's regional budgetary management. These results imply that in order to provide significant economic effects, fiscal independence must be paired with efficient public spending management

Effectiveness Ratio and Economic Growth

According to the study's findings, economic growth in the Bakorwil II region is negatively correlated with the effectiveness ratio. This result implies that improved economic performance is not always correlated with increased revenue realization. The effectiveness ratio evaluates local governments' capacity to meet revenue goals set forth in the regional budget. Higher effectiveness ratios show that local governments can meet or surpass their revenue goals, according to (Juliana et al., 2025).

According to public finance theory, funding development initiatives and enhancing public services depend on efficient revenue management. Higher revenue realization should ideally boost fiscal capacity and enable governments to make larger investments in social programs and infrastructure development that boost the economy. The study's empirical results, however, show that higher revenue effectiveness does not always lead to economic expansion. Increased taxation or retaliatory charges levied on consumers and businesses could be one reason for higher revenue realization.

If regional governments rely heavily on local taxes and charges to increase revenue, this may increase production costs and reduce business competitiveness. Consequently, economic activities may slow down, leading to lower economic growth. This phenomenon can also be interpreted through the Armey Curve theory, which suggests that excessive fiscal intervention may reduce economic efficiency. When government revenue collection becomes too aggressive, it may create distortions in economic activities and discourage private investment.

Previous studies provide mixed evidence regarding the relationship between fiscal performance and economic growth. (Ihwandi & Khoirunurrofik, 2023) found that improved regional financial performance contributes positively to inclusive economic growth. However, other studies suggest that excessive fiscal extraction through taxation may negatively affect business development and regional competitiveness.

In the Bakorwil II region, the negative relationship between revenue effectiveness and economic growth may also be influenced by the dominance of industrial and natural resource sectors. In regions such as Bojonegoro, Tuban, and Gresik, economic growth is strongly influenced by industrial production and private investment rather than government fiscal policy. Consequently, improvements in regional revenue performance may not necessarily translate into higher economic growth.

Activity Ratio and Economic Growth

The study's conclusions show that the Bakorwil II region's economic growth is positively impacted by the activity ratio. This outcome emphasizes how crucial

effective public spending is to promoting regional economic growth. The activity ratio shows how much of regional budgets are allocated to development as opposed to regular spending. Increased development spending means that local governments devote more funds to public investment, economic amenities, and infrastructure development.

From the perspective of public finance theory, government spending directed toward infrastructure and development projects can increase economic productivity and stimulate regional economic activities (Musgrave, 1959). Infrastructure investments improve transportation networks, reduce production costs, and enhance market accessibility. Similarly, endogenous growth theory emphasizes that public investment in infrastructure and human capital plays a crucial role in sustaining long-term economic growth (Fama, 1980). Development expenditure can generate multiplier effects by stimulating business activities and encouraging private investment.

Agency theory is also in line with the positive correlation between development spending and economic growth. The potential conflict between principals and agents in fiscal management can be reduced when local governments effectively direct fiscal resources toward productive sectors, improving economic results (Fama, 1980). These conclusions are also supported by empirical research. According to (Ginting et al., 2019), fiscal decentralization and efficient public expenditure support Indonesia's regional economic expansion. Similarly, capital expenditure is essential for promoting regional economic development, according to (Sunarya Sulaeman Politeknik Keuangan Negara STAN & Silvia Politeknik Keuangan Negara STAN, 2019).

In the context of the Bakorwil II region, development expenditure plays an important role in supporting economic activities across different sectors. Infrastructure development supports industrial growth in regions such as Gresik and Tuban, while investment in agricultural infrastructure and fisheries facilities supports economic activities in regions such as Lamongan and Nganjuk. Therefore, the findings of this study suggest that development-oriented public expenditure plays a crucial role in promoting sustainable economic growth in the Bakorwil II region.

Table 8. Comparison with Previous Empirical Studies

Author	Variable	Findings
Ramadhani (2019)	Fiscal independence	No significant effect on economic growth
Ihwandi & Khoirunurrofik (2023)	Fiscal performance	Positive effect on inclusive economic growth
Ginting (2019)	Fiscal decentralization	Positive relationship with regional economic growth
Sulaeman & Silvia (2019)	Capital expenditure	Positive impact on regional development

Author	Variable	Findings
Julian (2025)	Revenue effectiveness	Higher revenue realization reflects better fiscal performance
Oates (2006)	Fiscal decentralization	Improves efficiency of public resource allocation

CONCLUSIONS AND RECOMMENDATIONS

Using panel data regression, this study investigates the impact of regional financial performance ratios on economic growth in the Bakorwil II region of East Java Province between 2015 and 2024. The findings show that, despite a strong correlation, the financial independence ratio has little effect on economic growth. This implies that advances in locally generated revenue (PAD) have not been entirely converted into profitable public expenditures that can promote regional economic expansion.

The effectiveness ratio, on the other hand, demonstrates a correlation with economic growth, suggesting that local governments' ability to meet revenue targets enhances their fiscal capacity to fund development initiatives like public services and infrastructure. Thus, efficient revenue administration is crucial to promoting regional economic growth. Additionally, economic growth is positively impacted by the activity ratio. Increased economic productivity, infrastructure development, and investment appeal are all facilitated by a larger share of development spending in regional budgets, all of which eventually boost regional economic activity.

Regional governments are urged to prioritize productive public spending based on these findings, especially in the areas of infrastructure development, human capital enhancement, and assistance for small and medium-sized businesses. To guarantee that fiscal decentralization policies more successfully support regional economic development, the central government should also improve oversight and assessment of regional financial management.

FURTHER STUDY

When evaluating the findings, it is important to take into account the many limitations of this study. First, while other factors like investment, infrastructure quality, and macroeconomic conditions may also have an impact on economic growth, the analysis only considers three indicators of regional financial performance: the financial independence ratio, effectiveness ratio, and activity ratio. Second, the study's reliance on secondary data from regional financial reports and official statistical sources may restrict data control and in-depth sectoral analysis.

Third, the results may not be entirely applicable to other areas with distinct fiscal capacity and economic structures because the study's scope is restricted to the Bakorwil II region of East Java Province. In order to provide a more thorough understanding of the relationship between regional financial performance and economic growth, future research is advised to include additional variables related to regional economic performance, such as

investment and infrastructure development, and to employ longer observation periods or alternative econometric techniques.

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