

THE EFFECT OF LOCAL TAXES AND INTERGOVERNMENTAL TRANSFERS ON COMMUNITY WELFARE: EVIDENCE FROM INDONESIA, 2022-2024

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Abstract

This study examines the effect of local taxes and intergovernmental transfers on community welfare in Indonesia during 2022-2024. Community welfare is proxied by the Human Development Index (HDI). Using a quantitative explanatory approach, the study relies on secondary data drawn from official fiscal and statistical publications. The population comprises all 38 provinces in Indonesia (Badan Pusat Statistik, 2024). Purposive sampling was used to select provinces that provided complete and comparable data on local taxes, Special Allocation Funds, General Allocation Funds, Revenue Sharing Funds, and HDI for 2022-2024. As a result, 30 provinces met the criteria, producing 90 observations. Data were analyzed using descriptive statistics, classical assumption tests, multiple linear regression, the coefficient of determination, and t-tests. The results show that local taxes, Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds each have a positive and significant effect on community welfare. These findings support fiscal federalism theory, which suggests that subnational fiscal resources can improve welfare when they strengthen the ability of regional governments to provide public services and development programs. Practically, local governments need to strengthen local tax administration and improve the quality of expenditure financed by intergovernmental transfers so that fiscal resources are translated more effectively into human development outcomes.

Keywords: local taxes, intergovernmental transfers, community welfare, Human Development Index.

INTRODUCTION

Community welfare remains a central objective of public policy because regional development is ultimately judged by improvements in human well-being rather than by fiscal growth alone. In Indonesia, community welfare at the regional level is commonly proxied by the Human Development Index (HDI), which combines the dimensions of longevity and health, knowledge, and a decent standard of living (BPS, 2021). Official statistics show that Indonesia's HDI reached 75.02 in 2024, increasing from 74.39 in 2023, which indicates continuing national progress while still leaving important disparities across regions (BPS, 2025).

From the perspective of fiscal decentralization, this issue is highly relevant because local governments are expected to finance public services and support regional development through both their own revenues and transfers from the central government. Law Number 1 of 2022 concerning Fiscal Relations between the Central Government and Regional Governments places fairness, transparency, accountability, equalization of public services, and the improvement of community welfare among the core directions of Indonesia's intergovernmental fiscal system (Indonesia, 2022).

Within that framework, local taxes represent an important source of regional fiscal capacity, whereas intergovernmental transfers are designed to reduce disparities in fiscal resources across regions. The Directorate General of Fiscal Balance explains that the balancing instruments relevant to this study consist of the General Allocation Fund, the Special Allocation Fund, and the Revenue Sharing Fund, each of which supports decentralization through equalization, priority-based financing, or revenue-sharing mechanisms (Keuangan, 2024).

Previous empirical studies indicate that fiscal variables are relevant to welfare outcomes, although the magnitude and the channels of influence are not always identical across territorial settings and observation periods. Saragih (2018) found that local tax revenue had a positive and significant effect on HDI in Indonesia. Nashshar and Mulyana (2022) reported that Special Allocation Funds had a positive effect on HDI and also worked indirectly through capital expenditure. Patadang et al. (2021) showed that transfer components can also be associated with HDI, although the strength of the relationship may vary across regions.

The research gap remains open for at least two reasons. First, decentralization does not automatically improve human development unless local governments have sufficient capacity to translate fiscal resources into better education, health, and economic outcomes (Siswidiyanto & Sahputri, 2023). Second, many Indonesian studies still rely on observation periods that do not fully capture the early fiscal environment after the implementation of Law Number 1 of 2022 (Indonesia, 2022).

Based on that background, this study aims to analyze the effect of local taxes and intergovernmental transfers on community welfare in Indonesia during 2022-2024. In this study, community welfare is proxied by HDI, while intergovernmental transfers are operationalized into General Allocation Funds, Special Allocation Funds, and Revenue Sharing Funds. The scope of discussion is limited to the relationship between those fiscal variables and welfare outcomes at the provincial government level using official secondary data from public fiscal and statistical sources.

The contribution of this study is both theoretical and practical. Theoretically, this study is expected to provide updated empirical evidence on the relationship between local fiscal capacity, transfer mechanisms, and welfare under the current fiscal framework. Practically, the study is expected to offer input for local governments to strengthen local tax administration and to direct General Allocation Funds, Special Allocation Funds, and Revenue Sharing Funds toward programs that more directly support human development outcomes. The novelty of this study is explicitly located in the use of the 2022-2024 observation period and in the re-examination of the fiscal-welfare relationship in the early implementation stage of Law Number 1 of 2022 (Indonesia, 2022).

LITERATURE REVIEW AND HYPOTHESIS FORMULATION

Fiscal federalism theory explains that public functions and fiscal instruments should be allocated across levels of government according to efficiency, equity, and stabilization considerations (Musgrave, 1959). In this framework, subnational governments are expected to provide local public goods more efficiently because they are closer to local preferences and information conditions, while intergovernmental transfers are needed to correct vertical and horizontal fiscal imbalances (Oates, 1999).

In the Indonesian context, the relevance of fiscal federalism is visible in the design of fiscal decentralization, where local governments are expected to transform their own-source revenues and central transfers into better public services and development outcomes (Indonesia, 2022). However, decentralization does not automatically improve welfare when local governments lack the institutional capacity to convert fiscal resources into effective outputs and outcomes (Siswidiyanto & Sahputri, 2023).

From an operational perspective, local government capacity determines whether fiscal resources are translated into actual service delivery. Empirical evidence from decentralized Indonesia shows that stronger local government capacity improves public service delivery, which

means that the welfare effect of local taxes and transfers depends not only on the amount of funds but also on the way regional institutions manage them (Setiawan et al., 2022).

In this study, community welfare is measured by HDI because HDI captures welfare more comprehensively than a single monetary indicator. BPS defines HDI through the dimensions of health, education, and decent living standards, making it an appropriate proxy for evaluating whether fiscal resources are translated into broader human development outcomes (BPS, 2021).

Local taxes reflect the ability of subnational governments to mobilize their own fiscal capacity. In fiscal federalism theory, stronger own-source revenues expand local fiscal autonomy and increase the ability of local governments to provide services that are more closely aligned with regional needs (Oates, 1999). Empirically, local tax revenue has been found to positively and significantly affect HDI in Indonesia (Saragih, 2018). Therefore, local taxes are expected to positively affect community welfare.

H1: Local taxes have a positive effect on community welfare.

Intergovernmental transfers are theoretically important because they help reduce fiscal disparities across regions and support minimum service provision when own-source revenues are unevenly distributed (Oates, 1999). In the Indonesian fiscal system, the transfer instruments examined in this study consist of Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds, each of which has a different role in supporting decentralization and welfare improvement (Keuangan, 2026).

Special Allocation Funds are intended to finance specific regional activities that align with national priorities, especially in sectors closely related to human development (Indonesia, 2022). Previous research shows that Special Allocation Funds have a positive and significant effect on HDI and may also improve welfare indirectly through capital expenditure (Nashshar & Mulyana, 2022). This evidence supports the expectation that higher Special Allocation Funds allocation will improve community welfare.

H2: Special Allocation Funds have a positive effect on community welfare.

General Allocation Funds function as a general equalization transfer that helps regions finance their basic public service responsibilities (Indonesia, 2022). From the perspective of fiscal federalism, this equalization role is important because regions with different fiscal capacities still need sufficient resources to provide essential public goods (Oates, 1999). Empirical evidence shows that General Allocation Funds positively and significantly affect HDI in Indonesia (Regina et al., 2020). Therefore, General Allocation Funds are expected to positively affect community welfare.

H3: General Allocation Funds have a positive effect on community welfare.

Revenue Sharing Funds enlarge regional fiscal space by redistributing part of national tax and natural resource revenues to subnational governments (Indonesia, 2022). In fiscal federalism theory, this transfer mechanism helps align intergovernmental revenue assignments with regional expenditure needs (Musgrave, 1959). Prior evidence indicates that Revenue Sharing Funds can contribute to welfare improvement through their effect on HDI and related development spending (Patadang et al., 2021). Therefore, Revenue Sharing Funds are expected to positively affect community welfare.

H4: Revenue Sharing Funds have a positive effect on community welfare.

RESEARCH METHODS

This study uses a quantitative explanatory design to examine the effect of local taxes and intergovernmental transfers on community welfare in Indonesia during 2022-2024. A quantitative approach is appropriate because the study tests causal relationships among measurable fiscal variables using secondary numerical data (Sekaran & Bougie, 2016).

The population of this study consists of all 38 provinces in Indonesia during the 2022-2024 period (BPS, 2025). The sample was selected using purposive sampling because not all provinces met the data requirements of this study (Sekaran & Bougie, 2016). The selection criteria are: (1) the province publishes complete data on local taxes, Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds for 2022-2024; (2) Human Development Index data are available for the same period; and (3) the published data are consistent and comparable across years. Based on these criteria, 30 provinces were selected as the sample. Because each province was observed for three years, the final dataset comprised 90 observations.

The study uses secondary data collected through documentation from official fiscal and statistical sources. Data on local taxes, Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds are obtained from the APBD data portal and related regional fiscal reports published by the Directorate General of Fiscal Balance, while HDI data are obtained from official publications of Statistics Indonesia (BPS, 2025).

Community welfare is proxied by the Human Development Index (HDI). BPS defines HDI as a composite measure that reflects three basic dimensions of human development, namely a long and healthy life, knowledge, and a decent standard of living. Therefore, HDI is considered an appropriate proxy for community welfare in this study (BPS, 2021).

The independent variables in this study consist of local taxes, Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds. Local taxes are treated as a component of regional own-source revenue, whereas Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds are treated as intergovernmental transfers from the central government to provincial governments within the framework of fiscal relations between levels of government (Indonesia, 2022).

$$HDI_{it} = \alpha + \beta_1 LT_{it} + \beta_2 SAF_{it} + \beta_3 GAF_{it} + \beta_4 RSF_{it} + \epsilon_{it} \quad (1)$$

In Equation (1), HDI_{it} represents community welfare in province i at year t , LT_{it} denotes local taxes, SAF_{it} denotes Special Allocation Funds, GAF_{it} denotes General Allocation Funds, RSF_{it} denotes Revenue Sharing Funds, α is the constant, β_1 - β_4 are the regression coefficients, and ϵ_{it} is the error term.

Data analysis is carried out in four stages. First, descriptive statistics are used to provide an overview of the characteristics and distribution of the data. Second, classical assumption tests are employed to evaluate the feasibility of the regression model. Third, multiple linear regression analysis is used to estimate the effect of local taxes, Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds on HDI. Fourth, hypothesis testing is conducted using the t-test for partial effects and the coefficient of determination (R^2) to assess the explanatory power of the model at a 5 percent significance level (Sekaran & Bougie, 2016).

RESULTS AND DISCUSSION

Results

Before hypothesis testing, the data were first examined through descriptive statistics and classical assumption tests. The descriptive statistics covered the minimum value, maximum value, mean, and standard deviation of Local Taxes, Special Allocation Funds, General Allocation Funds, Revenue Sharing Funds, and Human Development Index (HDI) in order to provide an overview of the characteristics and distribution of the 90 observations derived from 30 provinces during 2022-2024. In addition, the regression model was evaluated through the normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test before hypothesis testing was conducted. Overall, the results of these tests indicate that the data and regression model meet the required assumptions, so the model is considered feasible and the hypothesis testing can be continued using multiple linear regression.

Table 1. Multiple Linear Regression Results

	Model	Unstandardized Coefficients		Standardized Coefficients		t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta				Tolerance	VIF
1	(Constant)	81.094	1.356			59.801	.000		
	Local Taxes	.021	.001	1.108	1.727	.010		.477	2.115
	Special Allocation Funds	.036	.006	.031	9.059	.015		.814	8.759
	General Allocation Funds	.001	.003	.080	5.196	.005		.719	5.249
	Revenue Sharing Funds	.011	.008	.857	4.347	.002		.318	3.708

Source: Statistical output from the research data.

Based on Table 1, the multiple linear regression equation can be written as follows: $HDI = 81.094 + 0.021LT + 0.036SAF + 0.001GAF + 0.011RSF$. The constant value of 81.094 indicates the estimated level of community welfare when the independent variables are assumed to be zero. The positive coefficients of all independent variables indicate that increases in local taxes, Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds tend to increase community welfare.

Hypothesis testing based on the t-statistic and significance value in Table 1 indicates that all proposed hypotheses are supported. Local taxes have a positive and significant effect on community welfare (Sig. = 0.010), so H1 is supported. Special Allocation Funds have a positive and significant effect on community welfare (Sig. = 0.015), so H2 is supported. General Allocation Funds have a positive and significant effect on community welfare (Sig. = 0.005), so H3 is supported. Revenue Sharing Funds also have a positive and significant effect on community welfare (Sig. = 0.002), so H4 is supported.

Table 2. Coefficient of Determination Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.752a	.704	.768	2.09008	1.951

Source: Statistical output from the research data.

Based on Table 2, the coefficient of determination (R Square) is 0.704. This means that 70.4 percent of the variation in community welfare can be explained by local taxes, Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds, while the remaining 29.6 percent is explained by other factors outside the model. The Durbin-Watson value of 1.951 is close to 2, indicating no serious autocorrelation problem in the regression model.

Discussion

The regression results show that local taxes have a positive and significant effect on community welfare. The coefficient of 0.021 with a significance value of 0.010 indicates that stronger local tax revenue is associated with a higher HDI. This finding is consistent with fiscal federalism theory, which argues that greater own-source revenue strengthens subnational fiscal autonomy and enables local governments to provide public goods that are more responsive to local needs (Oates, 1999). In the Indonesian context, this result is relevant to the continuing effort to improve human development while regional disparities remain visible despite the upward trend in national HDI (BPS, 2025).

Special Allocation Funds also show a positive and significant effect on community welfare. The coefficient of 0.036 and a significance value of 0.015 indicate that earmarked transfers directed

to priority sectors contribute to welfare improvement. This result supports fiscal federalism theory because targeted intergovernmental transfers help correct functional funding gaps when subnational governments need additional support to finance nationally prioritized services (Musgrave, 1959). The finding is also relevant to the Indonesian fiscal phenomenon in which improvement in education, health, and basic infrastructure still depends on the effective targeting of transfer funds across provinces (Indonesia, 2022).

General Allocation Funds have a positive and significant effect on community welfare, as reflected by a coefficient of 0.001 and a significance value of 0.005. Although the coefficient is smaller than those of the other fiscal variables, its positive sign indicates that general fiscal support still plays an important role in helping provincial governments maintain basic public services and regional development. This result aligns with the equalization logic in fiscal federalism theory, where transfers are used to reduce disparities in fiscal capacity across regions so that essential public services can still be delivered more evenly (Oates, 1999). In practical terms, the finding suggests that the broad-based support provided through General Allocation Funds remains important in provinces with weaker own-source revenue capacity.

Revenue Sharing Funds likewise have a positive and significant effect on community welfare. The coefficient of 0.011 and the significance value of 0.002 indicate that provinces receiving greater shared revenues tend to achieve better welfare outcomes. This finding is compatible with fiscal federalism theory because revenue-sharing arrangements help align intergovernmental revenue assignments with regional expenditure needs and enlarge local fiscal space (Musgrave, 1959). In the Indonesian setting, this result is important because provinces differ substantially in their revenue bases, including those linked to taxes and natural resources, so Revenue Sharing Funds can strengthen the fiscal ability of provincial governments to support welfare-oriented programs.

Taken together, the four fiscal variables show positive coefficients and individually significant relationships with community welfare, while the model explains 70.4 percent of the variation in the dependent variable. These results reinforce the core logic of fiscal federalism theory that welfare gains from decentralization depend on how subnational fiscal instruments are translated into public service outputs and development outcomes (Oates, 1999). The findings also resonate with the Indonesian phenomenon that fiscal decentralization alone is not sufficient without local government capacity, because the availability of funds must be matched by the institutional ability to convert those funds into improvements in education, health, and living standards (Siswidiyanto & Sahputri, 2023).

CONCLUSION

The results of this study indicate that local taxes, Special Allocation Funds, General Allocation Funds, and Revenue Sharing Funds each have a positive and significant effect on community welfare. These findings show that both local own-source revenue and intergovernmental transfers are important fiscal instruments for improving welfare outcomes at the provincial level. The coefficient of determination further indicates that the four variables explain a substantial share of the variation in community welfare across the sampled provinces.

The practical implication of this study is that provincial governments should not rely on only one source of finance. Local tax administration needs to be strengthened so that provincial governments can enlarge their fiscal capacity in a sustainable manner. At the same time, transfers from the central government need to be managed more effectively and directed toward expenditure programs that directly support education, health, infrastructure, and other welfare-related services.

This study has several limitations. First, community welfare is represented only by HDI, whereas welfare can also be reflected in other social and economic indicators. Second, the model focuses on fiscal variables and therefore does not incorporate other determinants such as poverty, economic growth, employment, governance quality, and regional expenditure effectiveness. Third,

the study relies on secondary fiscal data that describe realized revenues and transfers, but these data do not capture the quality of spending implementation, targeting accuracy, or the institutional process through which fiscal resources are translated into welfare outcomes.

Future research is suggested to include additional explanatory variables, incorporate alternative welfare indicators, and examine the role of spending quality or local government capacity as mediating or moderating factors. Further studies may also compare provincial groups or use alternative econometric specifications to obtain deeper evidence on how fiscal decentralization affects welfare outcomes in Indonesia.

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