

## **FISCAL DECENTRALIZATION AND LOCAL BUSINESS DEVELOPMENT: THE ROLE OF REGIONAL TAX POLICIES IN ECONOMIC GROWTH**

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### **Abstract**

This study aims to analyze the impact of fiscal decentralization on local business development through the implementation of regional tax policies to encourage economic growth. Fiscal decentralization provides greater authority to regional governments in managing revenue sources and determining fiscal policies according to the characteristics of their respective regions. In the context of regional economic development, regional tax policies are a strategic instrument that can create a conducive business climate, increase investment, expand employment opportunities, and strengthen local economic competitiveness. This study uses a literature review method by examining various scientific articles, academic books, policy reports, and previous research results related to fiscal decentralization, regional tax policies, local business development, and economic growth. The results of the study indicate that fiscal decentralization can have a positive impact on regional economic growth when accompanied by effective, transparent, and accountable fiscal governance. Regional tax policies that are proportional and oriented towards business development have been proven to increase local economic activity, particularly in the micro, small, and medium enterprise sector. In addition, the flexibility of regional governments in determining fiscal incentives also contributes to increased investment and economic productivity. However, this study also identified challenges in the form of disparities in fiscal capacity between regions, low effectiveness of regional tax administration, and the potential for excessive tax burdens on businesses. Therefore, synergy between the central and regional

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governments is needed to formulate adaptive and sustainable fiscal policies to create inclusive and equitable economic growth.

**Keywords:** Fiscal Decentralization, Regional Taxes, Local Business Development, Economic Growth, Regional Fiscal Policy

## INTRODUCTION

Fiscal decentralization is a policy strategy implemented by many developing countries to increase the effectiveness of regional economic development by delegating fiscal authority from the central government to local governments (Korotun et al., 2020). In the Indonesian context, the implementation of fiscal decentralization following the reforms has brought significant changes to regional financial management patterns, particularly in strengthening regional autonomy and the ability of local governments to determine the direction of economic development according to the characteristics of their respective regions. Through this authority, local governments have greater latitude to design regional tax policies, manage local revenues, and create a business climate conducive to local economic growth. Regional tax policy is no longer viewed solely as a regional revenue instrument, but also as a strategic tool to encourage investment, strengthen the micro, small, and medium enterprise sector, and enhance regional economic competitiveness.

In practice, the relationship between fiscal decentralization and local business development is an increasingly important issue to examine, particularly amidst increasing competition between regions to attract investors and strengthen the regional economic base. Local governments are required to create fiscal policies that balance efforts to increase regional revenues and maintain the sustainability of community economic activity. Excessively high regional taxes have the potential to hinder local business growth by increasing operational costs. Conversely, more adaptive and proportional tax policies can create a more competitive business environment, thereby encouraging increased investment and local business expansion (Nantharath et al., 2019). Therefore, the effectiveness of regional tax policies is crucial for the success of local-based economic development.

The development of economic globalization and digital transformation also influences the dynamics of regional fiscal policy. Regions not only compete at the national level but also face the challenges of global economic integration, which demands efficient governance and ease of doing business. In this context, regional governments need to design a tax system that is transparent,

accountable, and capable of providing legal certainty for businesses. Furthermore, optimizing the use of regional tax revenues for infrastructure development, improving the quality of public services, and developing human resources is a crucial factor in strengthening regional economic productivity (Hanif et al., 2020). Thus, fiscal decentralization is not only related to the transfer of financial authority but also concerns the ability of regions to manage fiscal resources productively to encourage inclusive economic growth.

On the other hand, the implementation of fiscal decentralization in various regions still shows disparities in fiscal capacity and governance quality. Some regions are able to utilize fiscal authority to create innovative policies that support local business development, while others still face limitations in regional revenue management, low-quality bureaucracy, and suboptimal oversight of budget use. This disparity causes the impact of fiscal decentralization on economic growth to be inconsistent across regions. In some cases, regional tax policies actually create additional burdens for businesses due to inefficient levies or overlapping regulations (Aritenang & Chandramidi, 2023). This situation indicates that the success of fiscal decentralization is heavily influenced by the institutional capacity of local governments to formulate and implement economic policies that support local business development.

Local business development plays a strategic role in creating jobs, increasing community incomes, and strengthening regional economic structures. Sustainably developing local businesses can be a key driver of regional economic growth by increasing production, distribution, and consumption activities. In this context, regional tax policies that support businesses can be a crucial stimulus for increasing economic productivity. Tax incentives, simplified tax administration, and investment-friendly fiscal policies are some forms of regional government intervention that can strengthen the growth of the local business sector (Hung & Thanh, 2022). Therefore, synergy between regional fiscal policies and local economic development strategies is necessary to create sustainable and equitable economic growth.

Research on the relationship between fiscal decentralization, regional tax policies, and economic growth remains a relevant topic requiring further in-depth study, particularly in the context of developing countries like Indonesia, which have highly diverse social, economic, and geographic characteristics. Most previous research has focused primarily on central-to-regional fund transfers and regional government financial performance, while studies specifically addressing the role of regional tax policies in supporting local

business development are relatively limited. In fact, regional tax policies have a direct impact on the investment climate and the sustainability of economic activity at the local level. Furthermore, the constant changes in regional tax regulations require an evaluation of the effectiveness of fiscal policy in driving regional economic growth (Thanh & Canh, 2020).

Given these conditions, this research is crucial to analyze how fiscal decentralization through regional tax policies can impact local business development and regional economic growth. This research is expected to provide theoretical contributions to the development of public economics and regional development studies, while also providing practical recommendations for local governments in designing more effective, equitable, and local economic-strengthening fiscal policies. By understanding the relationship between fiscal decentralization and local business development, local governments can formulate economic development strategies that are more adaptive to community needs and future economic challenges.

## **RESEARCH METHOD**

The research method used in this study is a literature review with a qualitative descriptive approach. This approach was chosen to analyze in-depth the relationship between fiscal decentralization, regional tax policy, local business development, and economic growth through various relevant scientific sources. Research data was obtained from national and international journal articles, academic books, government agency reports, and policy documents related to the implementation of fiscal decentralization and the dynamics of regional economic development. The literature collection process was carried out systematically by selecting sources that were highly relevant, published within a specific time period, and possessed reliable academic credibility. The main focus of the study was directed at how regional tax policy can influence the investment climate, local business competitiveness, job creation, and increasing regional original revenue as part of a sustainable economic development strategy.

Data analysis was conducted through the stages of identification, classification, interpretation, and synthesis of various previous research findings to gain a comprehensive understanding of the role of regional fiscal policy in driving economic growth. This study used content analysis techniques to examine patterns of relationships between variables and identify challenges and opportunities for implementing fiscal decentralization in various regions. Furthermore, the study results are compiled narratively and critically to

produce scientific arguments that can explain the effectiveness of regional tax policies in supporting local business development. Using a literature review method, this research is expected to provide conceptual and academic contributions to the development of public economics and serve as a reference in formulating regional fiscal policies that are more adaptive, productive, and oriented towards inclusive economic growth.

## **RESULT AND DISCUSSION**

### **The Impact of Regional Fiscal Independence on Regional Economic Competitiveness**

Regional fiscal independence is a key indicator in assessing the ability of local governments to independently finance development needs without heavy dependence on transfers from the central government (Pabayoy, 2025). In the context of regional economic development, the level of fiscal independence is closely related to a region's economic competitiveness because fiscal capacity determines the local government's capacity to provide infrastructure, improve the quality of public services, and create a conducive investment climate. Regions with high levels of local revenue tend to be more flexible in formulating development policies tailored to local characteristics and needs. This flexibility provides opportunities for local governments to develop leading sectors, strengthen economic productivity, and sustainably improve community welfare.

The impact of fiscal independence on regional economic competitiveness can be seen through a region's ability to allocate budgets effectively and efficiently. When local governments have adequate revenue sources, development programs do not rely solely on bureaucratic central transfer mechanisms, which are often time-consuming. This condition allows regions to more quickly respond to the economic needs of the community, including the construction of roads, ports, markets, industrial areas, and other public facilities that can boost local economic activity. Adequate infrastructure is a key factor in attracting investment because businesses tend to choose regions with high accessibility, low logistics costs, and adequate economic support (Maulidya & Yuliansyah, 2022). Therefore, regions with a strong level of fiscal independence generally have a greater ability to create a competitive business environment.

In addition to influencing infrastructure development, regional fiscal independence also impacts the quality of public services, a crucial component of regional economic competitiveness (Zulfikar et al., 2025a). Good public services, such as easy licensing, fast administrative services, quality education,

and adequate healthcare, can increase community productivity while fostering investor confidence in the stability of regional governance. Regional governments with strong fiscal capacity can implement digital-based service innovations and more effective bureaucratic reform. In the era of modern economic competition, the quality of public services is a strategic factor because investment considers not only natural resource potential but also the quality of governance and bureaucratic efficiency. Thus, increased fiscal independence will strengthen regions' ability to build competitive economic ecosystems that are adaptive to global change.

Fiscal independence also impacts a region's ability to develop leading economic sectors that align with local potential. Each region has distinct economic characteristics, such as agriculture, fisheries, tourism, the creative industry, and trade. When local governments have strong revenue sources, the development of leading sectors can be more optimally implemented through the provision of capital assistance, workforce training, technology development, and investment promotion. This strategy can increase the added value of the regional economy and expand employment opportunities for the community. In the long term, strengthening leading sectors will enhance regional competitiveness because regions are able to produce products and services that have comparative and competitive advantages in national and international markets (Zulfikar et al., 2025a).

On the other hand, low levels of fiscal independence can be an obstacle to increasing regional economic competitiveness. High dependence on central transfer funds limits local governments' freedom of movement in determining development priorities. Furthermore, regional financial management patterns that rely heavily on transfers often lead to weak innovation in exploring the potential of local revenues. This situation results in poor infrastructure quality, limited public services, and suboptimal local economic development. When regions are unable to create a competitive economic climate, investment tends to shift to other regions with better fiscal governance. As a result, regional economic growth becomes uneven and disparities between regions widen.

The impact of fiscal independence on regional economic competitiveness is also related to the capacity of local governments to maintain local economic stability. Regions with strong revenue sources tend to be more resilient to economic pressures, such as inflation, declining investment, and global economic crises. Local governments can use their fiscal capacity to provide economic stimulus, support MSMEs, and expand social protection programs for affected communities. This capacity is crucial for maintaining the sustainability

of regional economic activity. Conversely, regions with low fiscal capacity will experience difficulties in maintaining economic stability during external shocks due to budget constraints and high dependence on central government assistance (Widiastuty, 2025).

However, increasing fiscal independence is not only determined by the amount of regional original revenue, but also by the quality of regional financial management. Transparent, accountable, and results-oriented budget management are key factors in ensuring that fiscal capacity is truly capable of increasing regional economic competitiveness. In some cases, regions with high revenues may not be competitive if their budget management is ineffective. Therefore, regional financial governance reform is necessary through increasing the capacity of the apparatus, strengthening the oversight system, and implementing digital technology in fiscal management. These steps will increase the efficiency of budget use and encourage more inclusive economic development.

### **The Impact of Regional Tax and Levy Policies on Local Business Activity**

Regional tax and levy policies play a crucial role in shaping the dynamics of local business activity in various regions (Rusli, 2022). In the context of regional autonomy, local governments are empowered to manage local revenue sources through the implementation of taxes and levies aimed at supporting development and the provision of public services. Regional taxes, such as restaurant tax, hotel tax, advertising tax, and street lighting tax, are key instruments in increasing regional fiscal capacity. Meanwhile, regional levies are levied as payment for services or specific permits granted by the local government to the public and businesses. Although these policies serve as a source of regional revenue, their implementation often has various impacts on the sustainability and development of local business activities, both positive and negative.

On the positive side, regional tax and levy policies can create a more conducive business environment if regional revenue is allocated effectively for infrastructure development and improving the quality of public services. Adequate road infrastructure, modern market facilities, a good transportation system, and fast administrative services will improve the operational efficiency of businesses (Judijanto & Al-Amin, 2025). Under these conditions, businesses directly benefit from the taxes and levies they pay. Improved infrastructure quality can streamline the distribution of goods and services, thereby reducing logistics costs. Furthermore, stable public services contribute to increased

public convenience in conducting economic activities, ultimately increasing opportunities for local business growth.

Proportionally designed regional tax policies can also encourage a healthy investment climate. Rational and affordable tax rates provide certainty for businesses in developing long-term business strategies. In many cases, regions that create transparent and simple tax systems tend to be more attractive to investors and local entrepreneurs. Regulatory certainty is a crucial factor because businesses require stability in calculating operational costs and potential profits. When local governments manage taxes and levies professionally, business confidence in the government increases, leading to faster regional economic growth (Zulfikar et al., 2025b).

However, regional tax and levy policies can also have negative impacts if implemented excessively without considering the capabilities of local businesses. Excessively high tax burdens have the potential to increase production and operational costs. This situation is often felt by micro, small, and medium enterprises (MSMEs) with limited capital. Rising operational costs force businesses to raise prices for goods or services to maintain their operations. As a result, public purchasing power can decline and consumption slows. In the long term, this situation can hamper local economic growth by making trade less competitive.

Furthermore, the numerous types of levies imposed by local governments often create complex bureaucratic issues. Businesses must process various permits and administrative payments, which require additional time and costs. Lengthy bureaucratic processes can reduce business efficiency and create uncertainty in operations. In some regions, unintegrated levy practices can even trigger a high-cost economy. This situation causes some businesses to choose to conduct economic activities informally to avoid the burden of administrative and levy burdens they perceive as burdensome. If this phenomenon continues, potential regional revenues could actually decline as the formal tax base shrinks.

The impact of regional tax and levy policies is also evident in the competitiveness of local businesses. Regions with excessively high tax rates tend to be less competitive than regions implementing more business-friendly fiscal policies. Businesses tend to relocate investment or production activities to areas offering lower operating costs. Competition between regions to attract investment is becoming increasingly fierce, requiring local governments to consider the balance between increasing regional revenue and sustaining community economic activity. Non-adaptive fiscal policies can lead to

decreased investment interest, increased unemployment, and slowed growth of the local business sector (Nasution et al., 2021).

On the other hand, the digitalization of regional tax and levy systems is beginning to bring positive changes to local business activities. The use of electronic payment systems and digital-based administrative services can increase transparency, efficiency, and accountability in regional tax management. Businesses no longer have to deal with complicated administrative procedures because payments can be made online. Digitalization also helps local governments reduce the potential for revenue leakage and illegal levies. With a more modern system, the relationship between local governments and businesses becomes more effective, creating a healthier and more trustworthy business climate.

Regional tax incentive policies are also a fairly effective strategy in supporting local business growth, particularly in certain business sectors that contribute significantly to employment. Tax rate reductions, levy relief, or temporary exemptions from certain types of taxes can help businesses survive economic pressures. These policies have proven crucial, especially during periods of economic recovery when many businesses experience declining revenues. Fiscal incentives can increase business liquidity, enabling companies to maintain their operations and workforce (Drucker et al., 2020).

Therefore, regional tax and levy policies have a significant impact on local business activity. These impacts are not only related to increased regional revenue but also influence business efficiency, economic competitiveness, investment levels, and the sustainability of the local business sector. Therefore, regional governments need to implement balanced, transparent fiscal policies oriented toward sustainable regional economic development. Policies that consider the real conditions of business actors will be able to create a harmonious relationship between the regional government's interest in increasing revenue and the business world's need to develop competitively.

### **Challenges of Governance and Transparency in Regional Tax Management**

Regional tax management is a crucial instrument for supporting the fiscal capacity of local governments and serves as an indicator of the success of fiscal decentralization. Regional taxes not only serve as a source of local revenue but also serve as a means to strengthen local economic development, improve the quality of public services, and create regional independence in development financing (Salman et al., 2022). However, the implementation of regional tax management in various regions still faces serious challenges related to

governance and transparency. These problems arise from an imbalance between demands for increased regional revenue and the institutional capacity of local governments to manage the tax system effectively, accountably, and transparently to the public. In practice, regional tax governance often faces issues of suboptimal administration, weak internal oversight, poor integration of information technology, and limited public participation in tax management oversight.

One of the main challenges in regional tax governance is the low quality of the regional tax administration system (Khaltar, 2024). Many regional governments still use conventional administrative mechanisms, resulting in ineffective processes for taxpayer data collection, taxable object assessment, and tax collection. This situation has resulted in inaccurate tax data, ultimately impacting potential regional revenue. The lack of data integration between government agencies also hinders the creation of an efficient tax management system. In some cases, discrepancies in data between regional revenue agencies and licensing and population agencies result in many potential taxes not being optimally identified. This situation demonstrates that regional tax governance still requires strengthening in terms of institutional coordination and information system integration.

In addition to administrative issues, another significant challenge is the low capacity of human resources in regional tax management. Regional tax officials are required to possess adequate technical competencies in taxation, information technology, auditing, and public services. However, in reality, there are still limitations in the ability of officials to understand changes in tax regulations and the implementation of digital systems. These limitations hamper the effective implementation of bureaucratic reform in the regional tax sector. Furthermore, the lack of training and competency development prevents officials from providing professional and responsive services to the public. Consequently, taxpayer compliance rates remain low because the public perceives tax services as complicated, slow, and lacking transparency (Androniceanu, 2021).

Transparency issues are also a key issue in regional tax management. Transparency is necessary to build public trust in local governments' responsibility to manage regional revenues responsibly. However, in practice, many regions still lack adequate access to information regarding regional tax management. The public often lacks clarity on how tax revenues are used to support regional development. This lack of transparency has the potential to create negative perceptions of local governments and lead to low public

awareness of paying taxes. Weak transparency also increases the risk of abuse of authority, corruption, and illegal levies in the regional tax collection process.

Another governance challenge relates to weak oversight and accountability systems. Suboptimal internal oversight leads to a high potential for regional tax revenue leakage (Androniceanu, 2021). In some regions, regular and technology-based oversight of the tax determination and collection process is not yet implemented, opening up opportunities for tax revenue data manipulation. Furthermore, internal audit mechanisms and performance evaluations of regional tax officials are often not implemented consistently. This weak accountability can reduce the effectiveness of regional revenue management and undermine the legitimacy of regional governments in the eyes of the public. Therefore, strengthening digital-based oversight systems and implementing good governance principles are crucial steps to improve the quality of regional tax governance.

Developments in digital technology actually offer significant opportunities to increase the transparency and effectiveness of regional tax management. The implementation of electronic tax payment systems, the use of digital databases, and the integration of online tax services can accelerate administrative processes and minimize direct interactions that could potentially lead to irregularities. However, digital transformation in regional tax management still faces various obstacles, such as limited technological infrastructure, low digital literacy among the public, and uneven internet network quality in some regions. Furthermore, some local governments still face budget constraints in modernizing their tax systems. As a result, the implementation of regional tax digitalization has not been optimal and requires ongoing policy support from both the central and regional governments.

On the other hand, public participation in supporting transparency in regional tax management remains relatively low. Public awareness of the importance of regional taxes for development has not yet been fully established. Many taxpayers still view taxes as merely an economic burden without understanding their benefits for infrastructure development, education, health, and other public services. The lack of tax outreach and education is one factor contributing to low public participation (Awaluddin & Sari, 2026). Therefore, local governments need to establish more open communication with the public through the publication of tax utilization reports, the provision of public complaint services, and the enhancement of digital and community-based tax education.

Thus, the challenges of governance and transparency in regional tax management reflect the need for comprehensive institutional reform to create a more accountable, efficient, and service-oriented regional tax system. Strengthening the capacity of the apparatus, digitalizing the tax system, integrating data between institutions, and increasing public participation are crucial factors in improving the quality of regional tax management. Good transparency will strengthen public trust in local governments, thereby encouraging increased taxpayer compliance and optimizing local revenue. Ultimately, effective and transparent regional tax governance can be a crucial foundation for achieving sustainable and highly competitive regional development.

## **CONCLUSION**

This research demonstrates that fiscal decentralization plays a strategic role in encouraging local business development and strengthening regional economic growth through regional tax policies that are more adaptive to regional needs. Granting fiscal authority to regional governments allows for flexibility in determining economic development priorities, including providing tax incentives, developing infrastructure, and improving public services that support business activities. Effectively designed regional tax policies have been proven to improve the investment climate, expand employment opportunities, and encourage the growth of the micro, small, and medium enterprise sector, a key driver of the local economy. Furthermore, fiscal decentralization also provides space for regions to explore their diverse economic potential, tailored to regional characteristics, enabling more equitable and sustainable economic development.

Furthermore, this research also confirms that the successful implementation of fiscal decentralization is significantly influenced by the capacity of regional government governance to manage revenues and expenditures transparently, accountably, and efficiently. Excessively high regional tax policies without a commensurate improvement in the quality of public services have the potential to reduce business competitiveness and hinder investment. Therefore, synergy between the central and regional governments is a crucial factor in creating a stable fiscal policy that supports national economic growth. Strengthening institutional capacity, digitizing regional tax administration, and increasing community and business participation in the policy formulation process are important steps to ensure

that fiscal decentralization not only increases regional revenue but also creates a productive, inclusive, and highly competitive business ecosystem.

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