

Flypaper Effect and Fiscal Illusion in Village Financial Management: A Case Study of KP Village

*Flypaper Effect and
Fiscal Illusion*

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ABSTRACT

This study investigates the phenomenon of fiscal illusion and the flypaper effect in the financial management of KP Village in Serdang Bedagai Regency. The research aims to analyze the impact of fiscal decentralization, financial dependency, village income growth, spending efficiency, and the effectiveness of local revenue (PADesa) on village expenditure. Using a quantitative associative approach and multiple linear regression analysis, this study examines financial data from 2015 to 2024. The results show that while village revenue and expenditure have steadily increased, local revenue generation remains low, highlighting the village's dependence on intergovernmental transfers. The findings confirm the presence of the flypaper effect, where increased transfer funds lead to higher village spending without a corresponding increase in locally generated income. Significant factors influencing village expenditure include land and building tax, degree of decentralization, and spending efficiency, while other variables such as village income growth and transfer income have a limited impact. This study underscores the need for strengthening fiscal independence by enhancing local revenue generation strategies, improving budget management efficiency, and reducing reliance on external transfers. The research contributes to understanding fiscal behavior at the village level and provides policy recommendations to improve financial independence and sustainable village development.

Keywords: *Fiscal illusion, flypaper effect, fiscal independence, local revenue*

ABSTRAK

Penelitian ini mengkaji fenomena ilusi fiskal dan flypaper effect dalam pengelolaan keuangan di Desa KP yang terletak di Kabupaten Serdang Bedagai. Penelitian ini bertujuan untuk menganalisis pengaruh desentralisasi fiskal, ketergantungan keuangan, pertumbuhan pendapatan desa, efisiensi pengeluaran, dan efektivitas Pendapatan Asli Desa (PADesa) terhadap pengeluaran desa. Dengan menggunakan pendekatan kuantitatif asosiatif dan analisis regresi linier berganda, penelitian ini mengkaji data keuangan dari tahun 2015 hingga 2024. Hasil penelitian menunjukkan bahwa meskipun pendapatan dan pengeluaran desa mengalami peningkatan yang stabil, kemampuan desa dalam menghasilkan pendapatan lokal masih rendah, yang menandakan ketergantungan desa pada transfer antar pemerintah. Temuan ini mengkonfirmasi adanya flypaper effect, di mana peningkatan dana transfer menyebabkan peningkatan pengeluaran desa tanpa diikuti dengan peningkatan pendapatan lokal yang signifikan. Faktor yang berpengaruh signifikan terhadap pengeluaran desa mencakup pajak bumi dan bangunan, tingkat desentralisasi, dan efisiensi pengeluaran, sementara variabel lain seperti pertumbuhan pendapatan desa dan pendapatan

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transfer memiliki pengaruh yang terbatas. Penelitian ini menekankan pentingnya memperkuat kemandirian fiskal dengan meningkatkan strategi pengelolaan pendapatan lokal, meningkatkan efisiensi pengelolaan anggaran, dan mengurangi ketergantungan pada dana transfer. Penelitian ini berkontribusi dalam memahami perilaku fiskal di tingkat desa dan memberikan rekomendasi kebijakan untuk meningkatkan kemandirian keuangan dan pembangunan desa yang berkelanjutan.

Kata kunci: *Ilusi fiskal, flypaper effect, kemandirian fiskal, pengeluaran desa, pendapatan lokal*

INTRODUCTION

Government financial reports play an important role as a tool for evaluating performance and facilitating decision making regarding the efficiency and effectiveness of public resource management (Sonjaya et al., 2025). At the village level, financial reports usually take the form of budget realization reports which provide an overview of budget use and the efficiency of resource allocation (Indrijawati & Anwar, 2024). Village financial independence is the key to ensuring sustainable village development, because the ability to manage and utilize financial resources wisely supports more effective planning and budgeting to achieve better and more sustainable development results (Debnath & Bardhan, 2018; Phoek et al., 2024). Fiscal decentralization has been implemented to give local governments more authority in managing revenue and expenditure, with the main aim of encouraging regional economic growth and improving public service.

Fiscal decentralization often faces major challenges, especially the phenomenon of fiscal illusion, where stakeholders have little understanding of the available revenue sources and tax burdens (Maličká, 2017). This erroneous perception can lead to inefficient allocation of funds and increased spending that is disproportionate to adequate fiscal capacity (Hazarika & Nayak, 2022). Fiscal illusions become very real at the village level, where many villages are overly dependent on transfers from the central or regional government, while utilizing local revenue potential is minimal (Guziejewska, 2021). This excessive dependence on external funds creates the risk of unsustainable spending patterns, where villages tend to increase spending without focusing on developing local economic activities that can increase regional income (Rahmasari et al., 2024). This phenomenon is often called the flypaper effect, where an increase in external transfer funds causes an increase in village expenditure without being followed by an increase in efforts to generate local income. The case of KP Village in Pantai Cermin District, Serdang Bedagai Regency, illustrates this problem.

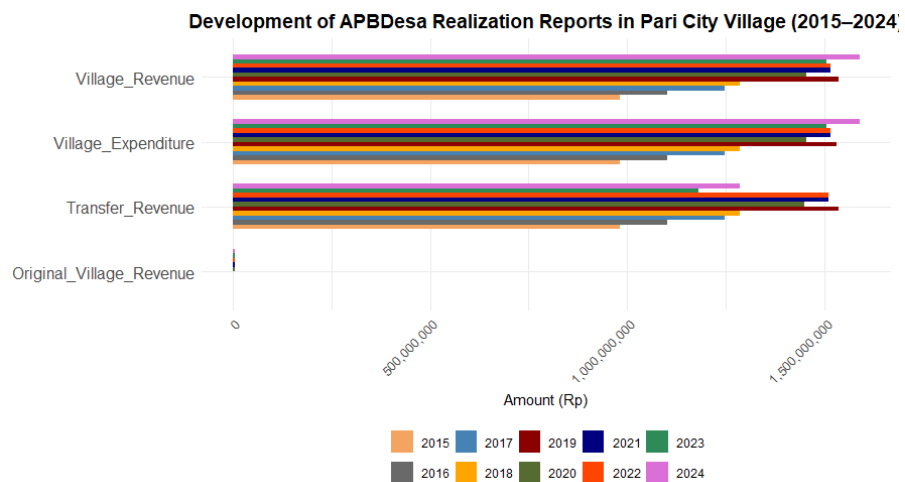


Figure 1. Development of the APBDesa Realization Report for Pari City Village

The development of the APBDesa realization report in Kota Pari Village from 2015 to 2024 which describes the trend of four main financial indicators, namely Village Income, Village Expenditure, Transfer Income, and Village Original Income. Village Revenue and Transfer Revenue exhibit a consistent upward trend, indicating improved financial performance and increased funding support over the years. Village Expenditure also shows a stable increase, reflecting a proportional allocation of funds to support village development programs. However, Original Village Revenue remains relatively low and fluctuates, suggesting that the village's ability to generate independent revenue is still limited and heavily reliant on external transfers. The consistent upward trend in Village Revenue and Expenditure underscores the village's growing fiscal capacity, while the limited growth in Original Village Revenue highlights the need to enhance local revenue generation strategies. Lack of clear strategies to increase local revenues and inefficiencies in budget management are important issues that need to be addressed to achieve greater financial independence (Prots et al., 2024).

Previous research suggests that excessive reliance on intergovernmental transfers can exacerbate fiscal imbalances and lead to suboptimal financial policies. Several studies show that as the General Allocation Fund allocation increases, regional expenditure increases, but this is not commensurate with the increase in fiscal independence at the regional level (Panfil, 2021). In addition, large transfer allocations do not always improve the quality of public services. High reliance on transfers reduces incentives for local governments to maximize their local revenue potential (Machfud et al., 2021). On the other hand, research also highlights the importance of optimizing Village Funds to help reduce the development gap between urban and rural areas and improve the local economy (Hartojo et al., 2022; Hilmawan et al., 2023). Village-Owned Enterprises (*Badan Usaha Milik Desa/BUMDes*), especially in the tourism and trade sectors, have played an important role in creating jobs and encouraging regional economic growth, which in turn contributes to poverty reduction (Tarlani et al., 2022; Revida et al., 2023). In addition, intellectual capital, such as skills and knowledge from local communities, is a valuable asset for driving economic development (Ovchinnikov & Ostoi, 2022).

This research aims to further explore the phenomenon of fiscal illusion in the financial performance of KP Village and analyze its impact on village expenditure management. This research will examine main fiscal indicators such as the degree of fiscal decentralization, financial dependency ratio, village income growth, spending efficiency, and effectiveness of local revenue collection (*Pendapatan Asli Desa/PADesa*). It is hoped that this research will provide valuable insights for local governments in strengthening fiscal independence and optimizing financial management to support more sustainable development. In addition, this research will analyze the impact of the flypaper effect on village financial management and emphasize the importance of transparency and public participation in village development planning (Yang, 2022). Local government financial systems, which rely heavily on intergovernmental transfers, are often associated with the occurrence of fiscal illusions, as local decision makers may not fully understand the long-term fiscal consequences of their spending (Guziejewska, 2021). This erroneous perception can lead to inefficiencies in financial management and suboptimal public expenditure decision making. Additionally, fiscal illusions often arise when voters are not fully aware of the tax obligations and costs associated with public services, which reduces their ability to be accountable for government actions (Numa, 2024). Therefore, increasing fiscal transparency and making government financial information more accessible and understandable to stakeholders are important steps to reduce the negative impact of fiscal illusion. Based on the explanation above, this research will focus on analyzing important aspects of fiscal independence, the role of local income, and the fiscal implications of excessive dependence on transfers in KP Village. This research will also evaluate village financial performance and highlight strategies to improve revenue collection and expenditure management to promote financial independence and sustainable development.

LITERATURE REVIEW

Agency Theory in Government

Regional government management must be supervised to ensure that management is carried out in full compliance with various applicable regulations and provisions (Mayasari & Arman, 2023). The results of the performance that has been implemented by the regional government will result in the information conveyed to the public being transparent and accountable (Abdi, 2023). This aims to be able to provide balanced information between parties *agent* with *principal*. In this way, the information conveyed will reduce the risk information asymmetry then the possibility of corruption crimes will decrease. Agency theory views that regional governments as agents for the principal community will act with full awareness of their own interests and considers that regional governments cannot be trusted to act in the best interests of the community. Agency theory a lot going on information asymmetry between the agent (government) who has direct access to information and the principal (society) (Rachman & Astri, 2024). There is information asymmetry is what allows fraud or corruption to occur by agent. As a consequence, local governments must be able to increase accountability for their performance as a mechanism checks and balances in order to reduce it information asymmetry (Hong et al., 2024; Saputra et al., 2024). Based on the theory above, it is concluded that effective regional government management requires strict supervision to ensure compliance with regulations and reduce information asymmetry, which can lead to corruption. Agency theory emphasizes that government officials, as agents, may act in their own interests rather than those of the public, highlighting the importance of transparency and accountability. To mitigate these risks, regional governments must implement strong checks and balances, enhance public information accessibility, and improve governance mechanisms to foster trust and integrity in public administration.

Village Income

Village income is all types of income originating from sources owned by the village or sources that are under village management (Syafingi et al., 2020). Village income is all village rights that are recognized as an addition to the net value of village finances obtained in each fiscal year (Parera et al., 2024; Ningsih et al., 2024; Sridarta et al., 2025). Village wealth is all village rights that are recognized as a source of village income managed by the Village Government. Government Regulation Number 71 of 2010 concerning Government Accounting Standards (SAP) in the statement of Government Accounting Standards Number 2 concerning Budget Realization Reports, states that income is all receipts from the State/Regional General Cash Account which add to current equity in the relevant fiscal year period which is the right of the government, and does not need to be paid back by the government. Regulation of the Minister of Home Affairs of the Republic of Indonesia Number 113 of 2014, village income is all money received through village accounts which is the right of the village in 1 (one) budget year which does not need to be paid back by the village. Village income is all village cash receipts that increase equity in the relevant fiscal year period and the right to become a village government that does not need to be paid back by the village government (Qiulin et al., 2024). Sources of Village Income based on Village Law Article 72 paragraph (1), village income is First, Village Original Income consisting of business results, asset results, self-help and participation, mutual cooperation, and other village original income. Second, State Revenue and Expenditure Budget Allocation (APBN). Third, part of the proceeds from regional taxes and regency/city levies. Fourth, Allocation of village funds which is part of the balancing funds received by the Regency/City. Fifth, financial assistance from the Provincial Regional Revenue and Expenditure Budget and Regency/City Regional Revenue and Expenditure Budget. Sixth, non-binding grants and donations from third parties and seventh, other legitimate village income.

Village Shopping

Expenditures in Indonesian government accounting are defined as all state/regional general treasurer expenditures that reduce current fund equity within a fiscal year and are not recoverable (Zein & Septiani, 2024). Village Expenditures refer to all payments from the village's general cash account that decrease the excess budget balance within a budget year, without repayment to the Village Government (Ginting et al., 2024). According to the Regulation of the Minister of Home Affairs Number 113 of 2014, Village Expenditures are all payments from the village account that constitute village obligations in one budget year, which will not be recovered. The allocation of village expenditures must align with village income, ensuring fiscal balance. Higher village income leads to increased expenditures, fostering infrastructure and hamlet development. Government Regulation Number 71 of 2010 on Government Accounting Standards (SAP) states that expenditures are all payments from the State/Regional general treasury account that reduce current fund equity without repayment. Village expenditures include employee expenditures, covering fixed income and allowances for Village Heads, Village Apparatus, and *Badan Permusyawaratan Desa* (BPD) (Sukmawati, 2019). Thus, village expenditures are regulated financial obligations ensuring fiscal balance and sustainable development. Increased village income leads to better infrastructure and services, while structured financial management supports governance and economic growth. Effective implementation of these regulations is crucial for financial stability and rural welfare enhancement.

Local Government Performance Measurement

Public sector performance measurement is carried out to fulfill three purposes *First*, Public sector performance measurement is intended to help improve government performance. Performance measures are intended to help the government focus on the goals and objectives of work unit programs. This will ultimately increase the efficiency and effectiveness of public sector organizations in providing public sector services. *Second*, public sector performance measures are used to allocate resources and make decisions. *Third*, public sector performance measures are intended to realize public accountability and improve institutional communication (Ulum, 2024; Saputra et al., 2024).

Village Financial Performance Ratio

Village financial performance can be assessed using various ratios. The Degree of Decentralization Ratio measures the contribution of PADesa to total revenue, where a higher PADesa share signifies stronger decentralization and reduced reliance on external funds. The Village Financial Dependency Ratio indicates reliance on financial transfers; high dependency risks fiscal instability when funding decreases (Nugroho et al., 2022; Rahmasari, 2024). Strengthening PADesa management enhances financial independence. Village Income Growth Analysis evaluates income trends, reflecting resource management success. Effective BUMDes contribute to economic growth and reduced inequality (Hilmawan et al., 2023). The PADesa Effectiveness Ratio measures internal revenue mobilization, though financial literacy and regulations pose challenges. The Village Expenditure Efficiency Ratio assesses financial resource utilization, where excessive bureaucracy hampers efficiency. Strengthening financial management is vital for village sustainability and independence.

Fiscal Illusions

Fiscal illusion refers to a misperception of fiscal parameters, causing the public to underestimate tax burdens and support higher government spending. The model highlights that tax complexity, indirect taxation, and inflation make it hard for the public to recognize their contributions, fostering the illusion that public spending is "free". Intergovernmental transfers reduce the perceived cost of public goods, increasing taxes and spending if demand is inelastic. This relates to the flypaper effect, where transfers lead to more spending than equivalent income increases. Studies in Brazil, Iran, and Argentina confirm this pattern (Paule-Vianez et al., 2020). To mitigate fiscal illusion, greater

transparency and incentive-based transfers are needed. Measuring fiscal strength in KP Village involves assessing PAD share, growth, and financial ratios to identify and correct fiscal misperceptions.

METHODS

This study uses a quantitative approach with an associative design to analyze the relationship between fiscal indicators and village spending. The quantitative approach was chosen because it allows objective measurement of the relationship between variables using statistical methods (Sugiyono, 2019). Multiple linear regression is used to estimate the effect of several independent variables on village spending, especially related to fiscal illusion, fiscal capacity, and the flypaper effect. The uniqueness of this study lies in the integration of the fiscal illusion analysis model with an evaluative approach to the effectiveness of village financial management in achieving fiscal independence. This study not only measures financial performance based on standard indicators, but also identifies the psychological impacts and policies that affect village spending. This study uses secondary data with independent variables including constant price GRDP, Land and Building Tax, PAD, degree of decentralization, village financial dependency ratio, village income growth, PAD effectiveness, village spending efficiency, and transfer income. The study population covers all villages in Serdang Bedagai Regency, with the main sample being KP Village, which was selected purposively because of its high fiscal dependency. Village Budget data for 2015–2024 were collected quarterly (32 observations). Data analysis involved classical assumption tests, multiple linear regression, and fiscal illusion analysis. The flypaper effect was confirmed if the regression coefficient of transfer income was significantly greater than Village PA ($\alpha < 0.05$). The R^2 test was used to assess the strength of the model, while the F test and t test were used to evaluate the significance of the model and variables. These findings provide insight into the dynamics of fiscal illusion in villages with high fiscal dependence, although generalizations need to be made with caution.

RESULTS

Village financial management that reflects the fiscal illusion of the Flypaper Effect hypothesis demonstrates the behavior of the village government. To detect fiscal illusions, it is necessary to calculate the PAD share and PAD Growth of the Pari City Village Government. The PAD share represents the contribution of the village's original income to village expenditure. Calculating the PAD share helps in understanding the extent of fiscal illusion in village financial management.

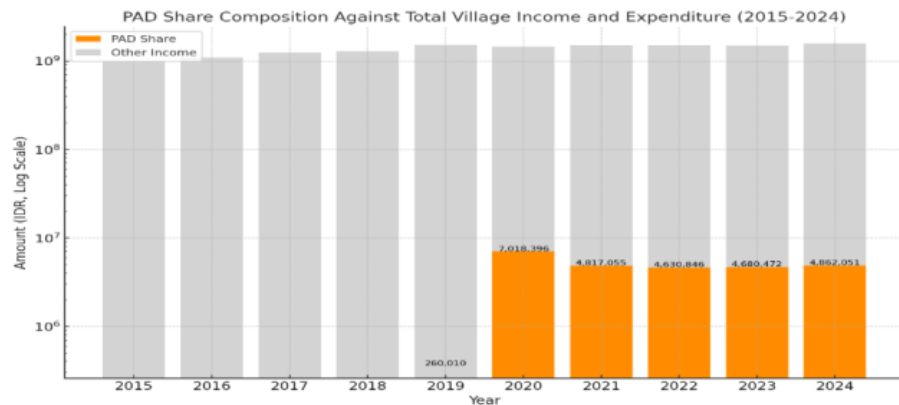


Figure 2. PAD Share in KP Village

From 2015 to 2018, there was no PAD and in 2019 it reached IDR260,010 (0.02% of total revenue), then increased sharply in 2020 to IDR7,018,396 (0.48%). From 2021 to 2024, the PAD contribution was stable in the range of 0.31% to 0.32%. The logarithmic y-axis clarifies PAD's small share relative to total revenue, while the orange color

highlights its growth. The data suggests the flypaper effect, where government transfers still dominate village revenue despite PAD's increase. This reliance on external funds indicates the need for stronger local revenue strategies to enhance fiscal independence.

PAD reflects the village's ability to generate its own revenue, indicating fiscal independence and financial sustainability. PAD growth analysis provides valuable insights into the effectiveness of local government policies and the village's capacity to reduce dependence on revenue transfers from higher levels of government. Tracking PAD growth over time helps identify patterns, challenges, and opportunities in improving village financial health. Therefore, continuous monitoring is needed to ensure the optimization of local resources. Figure 3 shows the annual growth rate of PAD in KP Village from 2015 to 2024.

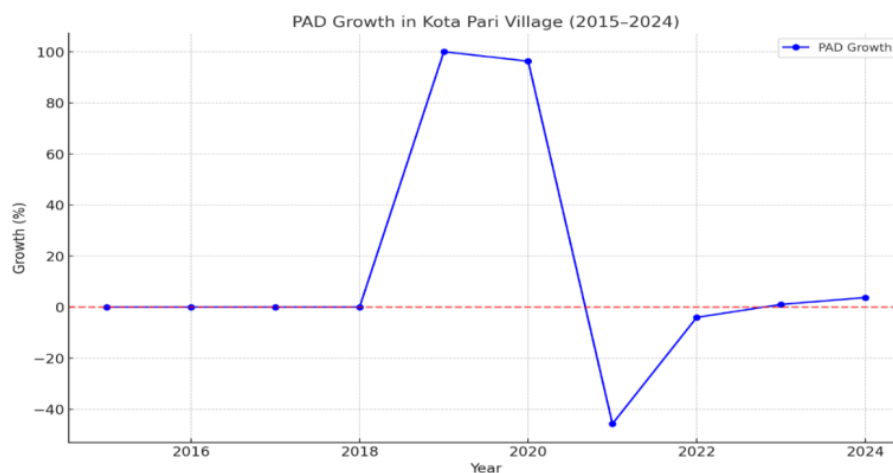


Figure 3. PAD Growth KP Village from 2015 to 2024

Based on figure 3, from 2015 to 2018, there was no PAD growth because the contribution of PAD to the village's revenue structure remained zero. The first significant increase occurred in 2019, with PAD rising dramatically by 100,000% compared to the previous year, although the absolute value remained relatively small at 260,010 IDR. This surge reflects a shift in policy or the optimization of village resources, which began to produce tangible results. In 2020, growth remained high at 96.295%, with PAD increasing to 7,018,396 IDR. This increase indicates an enhancement in the village's fiscal independence through the optimization of local revenue sources. However, in 2021, the growth trend experienced a sharp contraction of -45.699%. This decline was likely caused by external factors such as economic instability or fiscal policy adjustments, which affected the village's capacity to generate PAD. The trend started to improve between 2022 and 2024, with more stable growth rates. Although growth remained negative at -4.021% in 2022, it showed positive recovery in 2023 and 2024, with consecutive growth rates of 1.060% and 3.735%, respectively. This stability reflects a process of adaptation and strengthening of the village's revenue structure, leading to more sustainable growth. Therefore, this growth pattern suggests that although the contribution of PAD to the village's total revenue remains relatively small, there is potential for strengthening fiscal capacity through more targeted and sustainable revenue management strategies.

Before performing regression analysis, it is essential to conduct prerequisite tests to ensure that the model meets the necessary statistical assumptions. These tests help validate the reliability of the regression results by examining key assumptions such as normality, multicollinearity, heteroscedasticity, and autocorrelation. The normality test assesses whether the residuals are normally distributed, which is a fundamental requirement for regression analysis. The multicollinearity test ensures that independent variables are not highly correlated, preventing distortion in coefficient estimates. The heteroscedasticity test detects whether the variance of residuals is constant across

observations, while the autocorrelation test checks for correlation between residuals over time. The results of these prerequisite tests are summarized in Table 1.

Table 1. The results of the prerequisite tests

Test Type	Score	Description
Normality Test (Kolmogorov-Smirnov)	0.808 (Asymp. Sig)	The residual data is normally distributed because $p > 0.05$.
Multicollinearity Test (Tolerance & VIF)	Tolerance ≥ 0.10 , VIF ≤ 10	No multicollinearity occurs between independent variables.
Heteroscedasticity Test (Breusch-Pagan)	p-value = 0.652	No heteroscedasticity occurs because $p > 0.05$.
Autocorrelation Test (Durbin-Watson)	0.940	No autocorrelation occurs as the DW value falls within the range of -2 to +2.

Source: Processed Data, 2024

The results of the prerequisite test confirm that the regression model meets the required statistical assumptions. The normality test using Kolmogorov-Smirnov shows that the residuals are normally distributed ($p = 0.808$, $p > 0.05$), ensuring the validity of parametric statistical analysis. The multicollinearity test, assessed through Tolerance (≥ 0.10) and VIF (≤ 10), indicates no strong linear relationships among independent variables, confirming that each predictor contributes uniquely to the model. The heteroscedasticity test using Breusch-Pagan reveals a p-value of 0.652 ($p > 0.05$), suggesting that the variance of residuals is constant across different levels of the independent variables, fulfilling the homoscedasticity assumption. Lastly, the Durbin-Watson test yields a score of 0.940, indicating no autocorrelation in the residuals, which ensures the independence of observations. With these assumptions met, the regression analysis can be conducted with reliable and unbiased estimates.

Table 2. Simultaneous Test (F Test) Results

Analysis	Value
F-count	5.832
F-table	2.36
Sig.	0.000
Conclusion	Significant

The simultaneous test in this study aims to determine whether all independent variables (X) have a simultaneous influence on the dependent variable (Y). The results of the simultaneous test presented in Table 2 show that the F-count value is 5.832, which is greater than the F-table value of 2.36 at a significance level of 5% (0.05). The significance value (Sig.) is 0.000, which is below the threshold of 0.05. This indicates that all independent variables included in the model have a simultaneous and significant effect on village expenditure. Therefore, the regression model used in this study is statistically significant and appropriate for explaining the relationship between independent variables and village expenditure. The significance of the simultaneous test implies that factors such as Land and Building Tax (PBB), Degree of Decentralization, Village Financial Dependency Ratio, Village Income Growth, PAD Effectiveness Ratio, Village Spending Efficiency, Fiscal Illusion, and Transfer Income collectively influence the level of village expenditure. Even though some individual variables do not show significant partial effects, the overall influence of these variables in shaping village expenditure patterns is statistically confirmed through the F Test. This reinforces the need for a comprehensive village financial management strategy that considers all contributing factors to improve fiscal independence and optimize budget allocation.

Table 3. Partial Test (t Test)

Variable	Coefficient	t-count	p-value	Significance
Constant	-182.891	-0.269	0.79	Not Significant
X1 (GRDP at Constant Prices)	-0.084	-0.269	0.79	Not Significant
X2 (Land and Building Tax)	10.538	3.006	0.007	Significant
X3 (Village Original Income)	-0.682	-1.323	0.2	Not Significant
X4 (Degree of Decentralization)	1.261	4.102	0.000	Significant
X5 (Village Financial Dependency Ratio)	2.454	0.149	0.883	Not Significant
X6 (Village Income Growth)	20.889	1.201	0.242	Not Significant
X7 (PAD Effectiveness Ratio)	1.405	0.758	0.457	Not Significant
X8 (Spending Efficiency Ratio)	27.031	2.227	0.037	Significant
X9 (Transfer Revenue)	3.871	1.240	0.228	Not Significant

Source: Processed Data, 2024

The results of the Partial Test (t Test) research showed that not all independent variables had a significant effect on village spending. The variables Property Tax (X2), Degree of Decentralization (X4), and Village Expenditure Efficiency Ratio (X8) show a significant relationship with village expenditure, as indicated by their significance values, which are below the 0.05 threshold. This suggests that an increase in Land and Building Tax revenue directly impacts village expenditure, highlighting the significant contribution of local income sources to village government spending. Similarly, the Degree of Decentralization has a strong positive effect on village spending, indicating that greater village fiscal autonomy enhances financial management flexibility to meet local development needs. Furthermore, the Village Expenditure Efficiency Ratio also plays a significant role, suggesting that villages with higher expenditure efficiency tend to achieve more optimal budget realization.

On the other hand, the GDP variables at Constant Prices (X1), Village Original Income (X3), Village Financial Dependency Ratio (X5), Village Income Growth Analysis (X6), Village Original Income Effectiveness Ratio (X7), and Transfer Income (X9) do not show a significant influence on village spending in the model used. This indicates that although these factors have a role in the village financial system, their contribution to village expenditure is not strong enough if analyzed partially. These results also show that the main factors determining the amount of village spending are more related to aspects of taxation, fiscal authority, and efficiency in budget use, compared to macroeconomic aspects or dependence on transfer funds. Thus, this research emphasizes the importance of optimizing local tax revenues and increasing village fiscal capacity through more effective decentralization. Apart from that, efficiency in budget management is a crucial factor in increasing village fiscal independence. These results provide policy implications for regional and village governments in designing more sustainable financial management strategies, with an emphasis on increasing local tax capacity, strengthening fiscal decentralization, and encouraging efficiency in village budget realization in order to achieve more optimal fiscal independence.

Table 4. Coefficient of Determination Test

Analysis	Value
R Square	0.876
Adjusted R Square	0.826

The value R Square as big as 0.876 shows that the regression model used is able to explain 87.6% variation in village expenditure as the dependent variable. This indicates that the majority of changes in village expenditure can be explained by the independent

variables used in the model, such as Property Tax, Village Original Income, Degree of Decentralization, and Village Expenditure Efficiency Ratio. Meanwhile, the rest 12.4% influenced by other factors outside the model that are not included in this study. Plus, value Adjusted R Square as big as 0.826 indicates a more conservative level of adjustment to the number of independent variables in the model. This value indicates that after taking into account the number of variables in the model, approx 82.6% Variations in village spending can still be explained consistently by the independent variables used. Difference between R Square And Adjusted R Square which is not too large indicates that this model is quite stable and does not experience excessive overfitting. Overall, these results show that the regression model used has strong predictive power in explaining the factors that influence village spending. However, remembering that there are still 12.4% variations that are not explained by the model, further research can consider other variables that have the potential to contribute, such as social aspects, broader fiscal policies, or other external factors that can influence village financial management.

DISCUSSION

Village spending is an important component in improving development and welfare at the village level. Efficient village expenditure management can support village development and strengthen village income potential (Chung & Kim, 2024; Hartojo et al., 2024; Indraningsih et al., 2021). In the context of KP Village, although there has been an increase in land and building taxes which has had a positive effect on village spending, dependence on transfer income from the central government still presents a significant challenge. Hazarika & Nayak (2022), states that the phenomenon of fiscal illusion, where stakeholders lack understanding of existing sources of income and tax burdens, can lead to inefficient allocation of funds and increased spending that is not accompanied by an adequate increase in fiscal capacity. This is in accordance with the finding that the low original village income in Pari City causes dependence on transfer funds, which risks creating unsustainable spending patterns.

Besides that, the over-reliance on external funds risks creating unsustainable spending patterns, where villages are more likely to increase spending rather than develop the local economy which can increase the village's original income (Syafingi et al., 2020; Nugroho et al., 2022; Ginting et al., 2024; Indrijawati & Anwar, 2024). This dependence reduces incentives to develop local sources of income, which can exacerbate dependence on transfer funds and hinder long-term development in villages. Furthermore, the flypaper effect phenomenon expressed by Rahmasari et al. (2024), who stated that the flypaper effect phenomenon leads to a tendency to increase spending when transfer funds from outside the village increase, without trying to increase income from more independent local sources, indicates that increasing village spending in KP Village is often not in line with efforts to increase the village's original income.

It is important to note that dependence on fund transfers can reduce village fiscal independence, which is in line with research Panfil (2021), which confirms that the larger the General Allocation Fund (DAU) allocation, the greater the regional expenditure, but this is not in line with increasing regional fiscal independence. Therefore, low decentralization and dependence on fund transfers exacerbate the existing fiscal imbalance in KP Village. The Village Funds have a significant role in funding key development programs in villages, which underlines the importance of effective village fund management to support sustainable development (Madyan et al., 2020; Nugroho et al., 2022). Although Village Funds have great potential to increase development, their management must be carried out more efficiently to maximize their impact on the village economy.

In this case, the potential of Village-Owned Enterprises (BUMDes) should not be ignored. BUMDes, which play a role in the tourism and trade sectors, have also been proven to be able to create jobs and encourage regional economic growth. Therefore, optimizing BUMDes can be one solution to increasing village fiscal independence (Tarlani et al., 2022; Revida et al., 2023; Fitriani et al., 2024). Finally, transparency and

public participation in village development planning are very important. Yang (2022) stated, the importance of transparency and public participation in village development planning, which shows that openness in the management of village funds can increase accountability and sustainability of village development. Overall, despite efforts by the KP village government to manage village expenditure, major challenges remain, especially in reducing dependence on transfer funds and increasing village original income. Efficient management, increasing transparency, and optimizing local resources, such as BUMDes, are key steps to achieving sustainable village development and better fiscal independence.

CONCLUSION

This research highlights that fiscal illusion remains a major challenge in Pari City Village's financial management. While Land and Building Tax (PBB), degree of decentralization, and village expenditure efficiency ratios positively influence village spending, dependence on transfer funds remains high. This suggests that despite the potential to increase village original income (PAD), local resources are not yet optimized effectively. Introducing village financial ratio analysis, this study assesses fiscal performance through decentralization degree, financial dependency ratios, and expenditure management effectiveness. The findings confirm that fiscal sustainability requires optimizing PAD, reducing external fund reliance, and enhancing transparency and community participation in financial management. The study successfully identifies key factors affecting village spending and demonstrates that independent fiscal management mitigates fiscal illusion. It recommends that the Pari City Village Government strengthen financial policies by innovating income management, optimizing BUMDes, and implementing transparent financial monitoring. These efforts will promote sustainable development and long-term fiscal independence. Despite its valuable insights, this study has limitations. First, as a single-village case study, its findings cannot be generalized. Second, reliance on eight years of secondary financial data may not fully capture social and political influences on financial management. Future research should expand the study area and integrate quantitative and qualitative methods for a more comprehensive understanding of village fiscal management.

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