

## Does Village Fund Reduce Poverty and Disparity in East Java Province? Evidence from Indonesia

Vimbyarno Purbo Suseno<sup>1</sup>, Wildan Syafitri<sup>2</sup>, Nugroho Suryo Bintoro<sup>3</sup>  
Brawijaya University, Malang, Indonesia<sup>1,2,3</sup>  
Corresponding Author: [shulyvci009@gmail.com](mailto:shulyvci009@gmail.com)  
ORCID ID: <https://orcid.org/0009-0003-1619-2350>

### ARTICLE INFORMATION

#### Publication information

#### Research article

#### HOW TO CITE

Suseno, V. P., Safitri, W., & Bintoro, N. S. (2023). Does village fund reduce poverty and disparity in East Java Province? (Evidence from Indonesia). *Journal of International Conference Proceedings*, 6(1), 501-512.

#### DOI:

<https://doi.org/10.32535/jicp.v6i3.2433>

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Received: 20 February 2023

Accepted: 20 March 2023

Published: 27 March 2023

### ABSTRACT

From economic perspective, poverty arises as result of lack of access to capital and resources differences as explained in the vicious circle of poverty theory. In addition, differences in each region and various factors then create developed regions and underdeveloped regions. Developed regions are progressing and becoming a magnet for the capital, investment and residents of underdeveloped areas. Meanwhile, underdeveloped regions remain. Statistical data shows that the poverty rate is greater in rural areas than in urban areas. For this reason, the government's policy to overcome poverty and disparity is to carry out development from marginal areas, namely rural areas. With the enactment of Law Number 6 of 2014, the village becomes an autonomous region to be able to regulate and manage its community including aspects of planning, development, finance, and democracy independently. Since 2015, the government has allocated Village Funds to villages originating from the State Budget in the amount of 10% of and excluding Regional Transfers allocated in the State Budget. The results of the study show that Village Funds significantly reduces poverty, but it has no impact on disparity.

**Keyword:** Disparity, East Java, Poverty, Village Fund

## **INTRODUCTION**

Poverty defined as the inability to afford to meet one's fundamental needs, including those that are not related to obtaining food (Zuhdiyaty & Kaluge, 2017). According to the disparity perspective, poverty is an inequity that affects a population, particularly the poorest group in comparison to other communities (Sen & Moore, 1982). The poverty line for an individual is the sum of money needed to maintain a minimal standard of living and avoid being labeled as poor (Ravallion, 2012).

The resulting developed regions and lagging regions are the result of different reasons and variations in each region's conditions (Barro, 2015; Santoso, 2021). As they advance, developed regions are drawing people from less developed places as well as money flows and investments (Amalia, Santoso, & Sasongko, 2018). Meanwhile, undeveloped areas continue to be undeveloped or become more undeveloped. This inequality was initially brought on by variations in the population makeup of each region (Sjafrizal, 2017). Because of these variations, each location has a particular capacity to promote development and boost economic growth (Jamil, Ananda, & Prasetyia, 2022). Therefore, it is not surprising that each region typically has both highly developed and impoverished areas.

According to vicious circle of poverty theory, inequality of resources, unequal investment, and lack of access to finance all contribute to poverty (Nurkse, 1953). In other words, measures are required to ensure that ownership and distribution of capital, investment, and resources are equitable. However, it is difficult to do, particularly in Indonesia, an archipelagic nation with a wide range of physical, social, cultural, and other variations.

Most of the world's poor reside in rural areas, while some are locals who travel to other places in pursuit of a better life (Sugiyarto, Mulyo, & Seleky, 2016). As of March 2015, there are still a significant number of people living in poverty in Indonesia. The poverty rate in urban areas is 8.29%, or 10.67 million people, while it is much higher in rural areas, at 14.21%, or 17.94 million people (BPS, 2015).

The next government policy to address these issues is to provide special emphasis to the development of rural areas in order to combat poverty and development disparities between regions. The passing of Law No. 6 of 2014 regarding Villages was the first indication that this worry existed. This law grants villages the freedom to control and manage village interests in matters of governance, planning, development, finances, and village democracy (Maryunani, 2023; Rahmayati & Chrystiana, 2019; Subandi, Bachtiar, Ruwanti, Syofrin, & Juliandi, 2022).

To carry out the mandate and achieve these objectives, the village government needs to obtain financial support. Since 2015, the government has allocated Village Funds (VF) to villages sourced from the State Budget (APBN). The government's commitment to developing the village economy is realized by increasing VF from year to year. The amount of VF is ten percent (10%) of and outside the Regional Transfer allocated in the APBN in stages.

The research gap in the study lies in the need to examine the effectiveness of the Village Fund (VF) in addressing poverty and development disparities in the specific context of East Java Province. While the government has implemented the VF policy and increased its allocation over the years (Arifin et al., 2020; Diansari, Musah, & Othman, 2023), there

is a lack of comprehensive empirical evidence on its impact on poverty reduction and the reduction of regional disparities in East Java Province.

The novelty of this research lies in its focus on the specific region of East Java Province and its examination of the VF's role in reducing both poverty and development disparities. While previous studies have explored the impact of various policies on poverty reduction in Indonesia, there is a limited understanding of the effectiveness of the VF specifically in East Java Province. This study aims to fill this gap by providing empirical evidence on the VF's impact on poverty levels and development disparities in the region.

Furthermore, the research novelty extends to the consideration of both poverty reduction and development disparities simultaneously. By examining the VF's role in addressing both aspects, the study aims to provide a comprehensive analysis of the policy's effectiveness in promoting more equitable development and reducing poverty levels in East Java Province. This approach adds a nuanced understanding to the existing literature by exploring the potential synergies between poverty reduction and the reduction of development disparities through the VF policy.

This research contributes to the existing body of knowledge by investigating the specific context of East Java Province and examining the effectiveness of the VF policy in reducing poverty and development disparities. By providing empirical evidence and addressing these gaps, the study aims to inform policymakers and stakeholders involved in poverty alleviation and regional development efforts in Indonesia.

## **LITERATURE REVIEW**

### **Poverty**

Poverty is defined as the inability to afford to meet one's fundamental needs, including those that are not related to obtaining food (Zuhdiyaty & Kaluge, 2018). Poverty is a scenario or condition that a person or group of people encounters when they are unable to live their life to a standard that is regarded humane (Nasution, Nasution, & Lubis, 2020). Poverty is a situation of existence that refers to a person's inability to meet his fundamental wants and being unable to enjoy his life in terms of health, religious practice, education, employment, high income, and a respectable standard of living (Rohadin & Nurcahyo, 2019).

From an economic perspective, poverty is a result of three factors: (1) unequal income distribution due to disparities in community resource ownership; (2) disparities in the caliber of human resources; and (3) disparities in access to capital. The vicious circle of poverty theory explains these three reasons of poverty (Nurkse, 1953). According to the principle of the vicious circle of poverty, "a poor country is poor because it is poor".

Referring to the vicious circle of poverty theory, efforts are needed to ensure an even distribution/ownership of capital, investment, and resources. However, this condition is not an easy thing to achieve, especially in Indonesia which is an archipelagic country with various geographical, social, ethnic, cultural, and other differences. Based on BPS (2015) data, around 50% more poor people in Indonesia live in rural areas.

### **Disparity**

Simon Kuznets in Todaro, Munandar, and Sumiharti (2000) proposed a hypothesis suggesting an inverted U-curve relationship between income inequality and a country's development stage. According to this hypothesis, during the early stages of

development, there is an increase in regional development inequality and income distribution tends to be uneven. However, in subsequent stages, income distribution is expected to improve and become more equitable.

Economic development disparities between regions are a common occurrence during the process of regional economic growth. These disparities initially arise due to variations in demographic factors across regions. Consequently, each region possesses different capacities for economic growth and development. Therefore, it is not uncommon to find developed regions alongside relatively underdeveloped ones (Hardjoko, Santoso, Suman, & Sakti, 2021).

Significant disparities in economic progress among regions can lead to a dominant negative effect, known as the backwash effect, overshadowing the positive spread effect on regional growth, resulting in an imbalanced development process. The primary objective of economic development efforts, besides achieving maximum growth, is to eradicate and alleviate poverty, income inequality, and unemployment.

### **Village Fund**

Government Regulation Number 60 of 2014 provides the legal framework for the implementation of the Village Fund (VF) in Indonesia (Badan Pengawas Keuangan Republik Indonesia [BPK RI], 2014). According to this regulation, the VF is sourced from the State Budget (APBN) and constitutes 10% of the transfer funds allocated to the regions. The purpose of this allocation is to support the development and welfare of villages across the country. The VF is disbursed in stages, allowing for a systematic and controlled distribution of funds.

The VF plays a crucial role in empowering local communities and promoting sustainable development in rural areas. It is designed to address the specific needs and potentials of each village, taking into account their unique characteristics. The utilization of the VF covers a wide range of activities, both physical and non-physical, that contribute to the well-being and progress of the village. These activities can include infrastructure development, education and healthcare programs, economic initiatives, social empowerment projects, and disaster management efforts.

To ensure proper financial management and accountability, the Regulation of the Minister of Home Affairs Number 20 of 2018 on Village Financial Management provides guidelines for the categorization of Village expenditures (Direktorat Jenderal Bina Pemerintahan Desa Kementerian Dalam Negeri Republik Indonesia [Bina Pemdes Kemendagri], 2018). These categories include administration implementation, village development implementation, village community development, empowerment of village communities, and disaster management. This categorization helps ensure that the VF is allocated and utilized effectively, targeting areas that require the most attention and fostering sustainable growth within the villages (Arifin et al., 2020).

By implementing the VF policy, the Indonesian government aims to reduce poverty, bridge development disparities between urban and rural areas, and enhance the overall well-being of village communities (Arifin et al., 2020). It represents a significant step towards empowering local communities, enabling them to actively participate in the decision-making and development processes that directly impact their lives (Riani, Purwadi, & Urip, 2023). The VF policy, coupled with effective financial management and monitoring systems, holds great potential to create positive and lasting changes in the socio-economic landscape of rural Indonesia.

In the study conducted by Wahyuddin, Ramly, Djalil, and Indriani (2019), the Village Fund and *Gampong* Fund Allocations are compared to assess their effects on poverty reduction. The findings highlight contrasting effects, with the Village Fund demonstrating a positive and significant impact on poverty reduction. This implies that the allocation of the Village Fund can effectively contribute to poverty alleviation efforts.

Similarly, Hermawan, Istiqomah, and Ahmad (2019) investigate the impact of fiscal decentralization, particularly the provision of village funds, on poverty levels in provincial-level villages on Java Island. However, their study reveals a negative and significant effect of village funds on poverty in Java. This finding suggests a divergence from the previous study and indicates that the impact of village funds on poverty reduction may vary across different regions or contexts.

Furthermore, Faoziyah and Salim (2020) focus on the relationship between village expansion, poverty rates, and the Village Fund. Their research shows that a significant percentage (60.56%) of areas undergoing village expansion successfully reduced poverty rates. However, it is important to note that not all of these areas were able to decrease the percentage of underdeveloped villages or improve development at the village level, despite receiving a substantial increase in funds from the Village Fund (25.35%). This suggests that while the Village Fund may contribute to poverty reduction, there are other factors and challenges at play in achieving overall development and reducing disparities within expanded areas.

The similarities among these studies lie in their examination of the impact of the Village Fund on poverty reduction. However, there are notable differences in their findings, with one study highlighting positive effects, another indicating negative effects, and the third shedding light on the complexities of poverty reduction and development outcomes. These divergent findings indicate a need for further research to understand the underlying factors and mechanisms that shape the relationship between the Village Fund, poverty reduction, and overall development. Additionally, there is a gap in the literature regarding the specific factors and challenges that contribute to varying outcomes in different regions or areas undergoing village expansion. Future studies could explore these factors to provide a more comprehensive understanding of the effectiveness and limitations of the Village Fund in reducing poverty and promoting sustainable development.

## **RESEARCH METHOD**

This study uses a quantitative approach. Quantitative methods use quantitative information in the form of data that can be tested or measured, and can be transformed into tables, equations, or other forms that aim to test research hypotheses. The study utilizes secondary data in the form of panel data, which combines time series data and cross-sectional data. Panel data refers to observations of multiple individuals over consecutive time periods (Baltagi, 2005). The time series data covers the years 2015 to 2022, providing annual information. Meanwhile, the cross-sectional data encompasses 29 districts and 1 city that received Village Funds in East Java Province.

Unlike previous studies which only analyzed data from one district or village, this study used data from one province, namely East Java, with the aim of seeing a broader picture

and impact. The timing starts from 2015 because the Village Fund (VF) has just started to be implemented in 2015.

**Research Model**

This study makes use of the following model to examine how Village Funds affect poverty and disparity.

Model 1:  $POV_{it} = \alpha_0 + \alpha_1 VF_{it} + \alpha_2 RB_{it} + \alpha_3 GRDP_{it} + \alpha_4 RMW_{it} + \epsilon_{it}$

Model 2:  $DIS_{it} = \alpha_0 + \alpha_1 VF_{it} + \alpha_2 RB_{it} + \alpha_3 GRDP_{it} + \alpha_4 RMW_{it} + \epsilon_{it}$

where:

POV = poverty percentage

DIS = income disparity (Gini Ratio)

VF = Village Fund

RB = Regional Budget (APBD)

GRDP = Gross Regional Domestic Product

RMW = Regency/City Minimum Wage

**RESULTS**

According to the regression findings, the variable representing the Village Fund exhibits a negative coefficient of -0.0000027. This indicates that for every one-unit increase in the Village Fund, there will be a corresponding decrease of -0.0000027 in the number of individuals living in poverty.

**Table 1.** The Determinants of Poverty

Dependent Variable: POV (Y1)				
Method: Panel Least Squares				
Sample: 2015 2022				
Periods included: 8				
Cross-sections included: 30				
Total panel (balanced) observations: 240				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	26.26876	0.712428	36.87217	0.0000
VF (X1)	-2.70E-06	8.07E-07	-3.351381	0.0010
RB (X2)	-1.62E-07	5.43E-07	-0.298553	0.7656
GDRP (X3)	-5.13E-07	1.42E-07	-3.606870	0.0004
RWM (X4)	-0.000773	0.000671	-1.151357	0.2509
R-squared	0.985211	Mean dependent var		20.43688
Adjusted R-squared	0.982841	S.D. dependent var		3.706107
F-statistic	415.8449	Durbin-Watson stat		1.646456
Prob(F-statistic)	0.000000			

Source: Author's Calculation (2023)

These results align with previous studies, including research conducted by Susilowati, Susilowati, and Hadi (2017), which demonstrated that Village Funds played a role in reducing poverty levels within East Java Province. Additionally, another study by Sigit and Kosasih (2020) concluded that VF had a positive impact on poverty alleviation in Indonesia.

**Table 2.** The Determinants of Disparity

Dependent Variable: DIS (Y2)				
Method: Panel EGLS (Cross-section random effects)				
Sample: 2015 2022				
Periods included: 8				
Cross-sections included: 30				
Total panel (balanced) observations: 240				
Swamy and Arora estimator of component variances				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.225116	0.201413	1.117682	0.2648
VF (X1)	-0.023268	0.015368	-1.514093	0.1313
RB (X2)	0.118724	0.049563	2.395437	0.0174
GDRP (X3)	-0.049142	0.028720	-1.711045	0.0884
RMW (X4)	0.006267	0.039549	0.158463	0.8742
R-squared	0.037325	Mean dependent var		0.186543
Adjusted R-squared	0.020939	S.D. dependent var		0.014462
F-statistic	2.277859	Durbin-Watson stat		1.788462
Prob(F-statistic)	0.061675			

Source: Author's Calculation (2023)

The VF's limited impact on reducing income inequality is an important aspect to consider (see Table 2). Despite its positive effect on poverty reduction, the Village Fund has not effectively increased the average income of lower-level villagers. This suggests that there is still room for improvement in utilizing the Village Fund to address income disparities within villages (Viverita, Astuti, Martdianty, & Kusumastuti, 2022).

## **DISCUSSION**

### **The Effect of Village Funds on Poverty and Disparity**

Through the VF, village communities are provided with business capital, community empowerment, and increased competence and productivity so that they become independent and prosperous village communities. The use of VF is channeled into physical and non-physical activities that suit the characteristics and potential of the village and involve and empower village communities.

Three types of spending are considered to have a direct impact on community development efforts and poverty alleviation in the village: (1) Village Development Expenditures; (2) Expenditures for Village Community Development, and (3) Spending on Village Community Empowerment.

Village Funds delivered to village communities, among others, through the following activities: (1) Cash Labor Intensive (PKT-DD); (2) Direct Cash Assistance (BLT-DD), and (3) Investment in Village Owned Enterprises (BUMDes).

Infrastructure development activities and maintenance of the rural environment through PKT-DD activities involving local residents means providing employment opportunities for rural communities. In addition, the formation of BUMDes can create sustainable jobs that directly affect the income of villagers. Meanwhile, loans or revolving funds can help village communities who need capital assistance for businesses and to be productive.

The research findings indicate that the Ministry of Village has responded to the challenges posed by the COVID-19 pandemic by amending the regulations related to

the utilization of Village Funds. This response is reflected in the issuance of the Regulation of the Village Minister of PDPT Number 6 of 2020 (Kementerian Sekretariat Negara RI, 2020) and the Second Amendment (Permendes PDPT Number 7 of 2020) (BPK RI, 2020). These revised regulations emphasize two main objectives for the allocation of Village Funds during the pandemic.

Firstly, the amended regulations prioritize self-managed infrastructure development using the Village Cash Workforce (PKT-DD) system. This approach aims to enhance the economic resilience of villages and increase community income. By empowering the local workforce, the Village Funds can be utilized to support the development of infrastructure projects that directly benefit the community, especially during challenging times such as the COVID-19 pandemic.

Secondly, the revised regulations highlight the importance of strengthening public health measures in the prevention and management of COVID-19. The Village Funds are directed towards supporting initiatives that focus on improving public health infrastructure, providing access to healthcare services, and implementing preventive measures to mitigate the spread of the virus within the villages. This strategic allocation of funds aligns with the broader national efforts to combat the pandemic and safeguard the health and well-being of the rural population.

Furthermore, in order to accommodate the government's policy of providing Village Fund Direct Cash Assistance (BLT-DD) to those affected by poverty and the COVID-19 pandemic, the Ministry of Finance has also issued Regulation Number 50 of 2020. This regulation amends the existing Minister of Finance Regulation Number 205/PMK.07/2019 concerning Village Fund Management (Kementerian Keuangan Republik Indonesia [Kemenkeu RI], 2019). It specifically outlines the payment details and conditions for the BLT-DD, which is intended to be provided for a period of six months.

According to the amended regulations, eligible recipients of the BLT-DD are impoverished families and individuals who have been affected by the COVID-19 pandemic and have not received assistance from other government programs such as BPNT, PKH, or the provincial and district/city governments. The assistance amount is set at Rp.600,000 for the first three months per beneficiary family (KPM), and it is then reduced to Rp.300,000 for the subsequent three months. This targeted cash assistance aims to provide immediate relief and support to the most vulnerable households affected by the socio-economic impacts of the pandemic.

The research findings highlight the proactive measures taken by the Ministry of Village and the Ministry of Finance to adapt the utilization of Village Funds to the specific needs and challenges posed by the COVID-19 pandemic. These amendments demonstrate the government's commitment to supporting economic resilience, public health measures, and providing direct assistance to those most affected by the crisis at the village level.

The calculation method for determining the number of BLT-DD beneficiaries in each village is based on the total amount of Village Funds received. Villages that receive less than IDR 800,000,000 allocate a maximum of 25% of the total Village Fund for BLT-DD. Villages receiving between IDR 800,000,000 and IDR 1,200,000,000 allocate a maximum of 30%, while villages receiving more than IDR 1,200,000,000 allocate 35%. In cases where the budget is insufficient to cover the number of poor households, villages can request additional allocation with approval from the District Government.

According to data from BPS (2015), East Java Province had a poverty rate of 10.48% in 2022, equivalent to 4,181,290 people. The variable coefficient of the Village Fund indicates that an increase of IDR 10,000,000 is required to reduce poverty by 1 unit. Therefore, to alleviate poverty in East Java Province through Village Funds, an estimated additional amount of IDR 1,548,625,925,926 is needed, assuming other variables remain constant. This amount is calculated by multiplying the required increase per poor population unit (IDR 370,370.37) by the total number of poor people in the province (4,181,290).

Supporting this perspective, research conducted by Sigit and Kosasih (2020) emphasizes the need for increased innovation in the utilization of the Village Fund. The study argues that the focus should not solely be on infrastructure development, which although it provides temporary employment opportunities for local workers, does not lead to sustained economic improvement. Instead, there is a call for innovative approaches in utilizing the Village Fund that directly and sustainably enhance the local economy.

To achieve this, the research suggests exploring avenues such as job training and certification programs that can enhance the skills and employability of village residents. By equipping individuals with marketable skills, the Village Fund can contribute to long-term income generation and economic empowerment. Additionally, establishing and strengthening micro, small, and medium enterprises (MSMEs) based on the village's potential can provide sustainable sources of income for the community (Novianti & Widianti, 2021). It is crucial to involve all members of the village community in these initiatives to ensure inclusivity and maximize the impact of the Village Fund.

These findings highlight the need for a more comprehensive and holistic approach in utilizing the Village Fund. By diversifying the utilization of the funds and incorporating innovative strategies, it is possible to address income inequality and promote sustainable economic development within villages. Policymakers and stakeholders involved in the implementation of the Village Fund should consider these recommendations to optimize its impact on income improvement and create more equitable outcomes for all villagers.

## **CONCLUSION**

The findings indicate that the Village Fund has a significant impact on reducing the poverty rate in East Java. The analysis reveals a negative coefficient, suggesting that an increase in the Village Fund is associated with a decrease in poverty. This highlights the importance of the Village Fund as a policy tool in addressing poverty and promoting socio-economic development in the region. The results emphasize the potential effectiveness of the Village Fund in contributing to poverty reduction efforts in East Java.

Through the Village Fund, village communities are provided with business capital, community empowerment, and increased competence and productivity so that they become independent and prosperous village communities. The existence of BUMDes can open up sustainable employment opportunities which directly affect the income of villagers. Meanwhile, loans or revolving funds can help village communities who need capital assistance for businesses and to be productive. During the COVID-19 pandemic, the Village Fund played a role through policy changes, namely (1) prioritizing self-managed infrastructure development with the Village Cash Work Intensive system to strengthen village economic resilience and community income, (2) distribution of Village Fund Direct Cash Assistance to poor residents and affected by COVID-19.

In another aspect, the Village Fund has not been able to reduce the level of income inequality. The policy of using Village Funds should not only focus on infrastructure development which does provide direct economic improvement through employment of local workers but only on a seasonal basis. Innovations are needed in the use of Village Funds that can improve the community's economy directly and sustainably, such as job training and certification, establishing and strengthening MSMEs according to village potential by involving all village communities.

This study utilized regression analysis to determine the relationship between the Village Fund variable and poverty. However, this method does not provide a comprehensive understanding of the underlying mechanisms or potential mediating factors involved in this relationship. Subsequent research could explore the mediating factors that influence the relationship between the Village Fund and poverty. For instance, social, cultural, or other policy-related factors that may moderate the impact of the Village Fund on poverty and disparity.

#### **ACKNOWLEDGMENT**

This research was conducted independently by the authors and did not receive any specific funding from other parties.

#### **DECLARATION OF CONFLICTING INTERESTS**

The purpose of this study is for academic only and there is no personal interest from authors.

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