

IFG Progress Weekly Digest

Indonesia's 2025 Transfer Cut: How Far Did the Fiscal Retrenchment Spill into Regional Economy?



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- *Subnational spending contracts by more than transfers do: across 38 provinces, consolidated expenditure falls by 7.2 percent in 2025, compared with a 4.9 percent decline in TKD receipts, while 84 percent of provinces record lower spending than in the preceding year.*
- *The absence of a clear cross-provincial GRDP relationship should not be interpreted as evidence of no economic effect: after excluding two extreme GRDP observations, the 2025 cross-section has limited statistical power, with an approximate minimum detectable local fiscal multiplier of 1.26.*
- *Sectoral weakness is uneven rather than uniform: construction records negative real growth in 26.3 percent of provinces and financial activity excluding 15.8 percent, while insurance and pension-fund activity remain positive across all 38 provinces. Insurance resilience therefore reflects the breadth of positive growth rather than exceptional growth performance.*

Indonesia entered the 2025 fiscal year under an explicit expenditure-efficiency mandate. Presidential Instruction No. 1 of 2025 directed both central and subnational budgets toward efficiency savings, and the instruction was operationalised on the transfer side through Minister of Finance Decree No. 29 of 2025, issued on 3 February 2025. The decree adjusted Transfer to Regions (Transfer ke Daerah, TKD) allocations by Rp50.59 trillion, distributed unevenly across components: physical Special Allocation Grants and Revenue-Sharing arrears absorbed the deepest adjustment, while General Allocation Grants and Village Funds were adjusted far more modestly.

Public discussion of the measure has largely proceeded on an assumption rather than an observation. Because subnational governments hold substantial accumulated budget surpluses (Sisa Lebih Perhitungan Anggaran, SiLPA), together with own-source revenue and financing instruments, the adjustment was widely expected to be absorbed through those buffers, leaving realised expenditure broadly protected. The size of an allocation adjustment at the centre does not translate mechanically into lower spending at the regional level. The magnitude of the pass-through is an empirical question.

That question has not been answered systematically, in part for a mundane reason: realised regional budget data are published at two levels that are not comparable, and the difference between them is large enough to swamp the effect of interest. This naturally raises an empirical question: Did the 2025 transfer adjustment translate into lower realised subnational spending, and how far did that adjustment extend beyond regional budgets into aggregate and sectoral economic activity?

Methodology

The analysis uses realised regional budget data published by the Directorate General of Fiscal Balance, Ministry of Finance, for fiscal years 2020 through 2025, together with Provincial GRDP (2010 Series) published by Statistics Indonesia. In addition to aggregate GRDP, the sectoral benchmark uses Construction, Financial and Insurance Activities, and the Insurance and Pension Fund subcategory, all measured at constant 2010 prices. Financial activity excluding insurance is constructed as total Financial and Insurance Activities minus Insurance and Pension Funds. The unit of observation is the province-year.

Table 1. Indicators and Dimensions Examined

Test	Dimension	Indicator
Test 1	Fiscal transmission	Annual change in transfer receipts and consolidated subnational expenditure
Test 2	Breadth of retrenchment	Share and distribution of provinces recording negative expenditure growth
Test 3	Regional output counterpart	Aggregate and provincial real GRDP growth
Test 4	Sectoral transmission benchmark	Real PDRB growth in construction, financial activity excluding insurance, and insurance and pension funds
Test 5	TKD-sector relationship	2025 cross-sectional relationships and 2022–2025 within-province comparisons

Note: all fiscal indicators are measured at the consolidated level, comprising the provincial government together with all district and municipal governments within the province.

Why Consolidated Panel?

Realised regional budget data may be reported at two different levels: the provincial government alone, or the consolidated level combining the provincial government with all district and municipal governments within its territory. The difference is substantial because a large share of intergovernmental transfers is received directly by district and municipal governments rather than recorded in the provincial government budget alone.

Combining these two reporting levels within a single time series would create an artificial discontinuity that could be mistaken for a fiscal adjustment. The analysis therefore uses a consistent consolidated unit of observation throughout, covering the provincial government together with all district and municipal governments within each province. For 2020–2024, the consolidated series is reconstructed from realised APBD records, while the 2025 observations are taken from the consolidated fiscal dataset. This ensures that changes over time reflect fiscal developments rather than changes in government coverage.

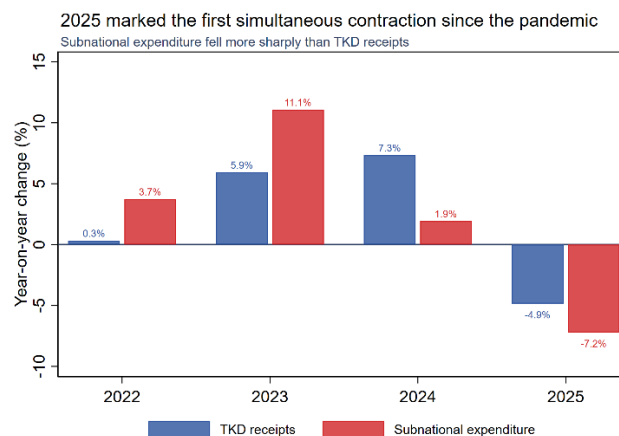
Two data treatments are applied to preserve comparability across years. First, TKD growth in 2021 is not reported because the 2020 accounts use the previous chart of accounts, creating a classification break that prevents a consistent year-on-year comparison. Second, the panel is unbalanced because four newly created Papua provinces enter the dataset only from 2023 onward. The sample therefore contains 34 provinces in 2020–2022 and 38 provinces in 2023–2025.

Results

Test 1: Aggregate Contraction

Exhibit 1 shows a clear break in 2025 from the pattern observed in previous years. Between 2022 and 2024, both TKD receipts and subnational expenditure continued to increase, although at different rates. In 2025, however, both series contracted for the first time over the observation period. TKD receipts fell by 4.9 percent, while subnational expenditure declined more sharply by 7.2 percent. The 2.3-percentage-point gap indicates that the aggregate contraction in regional spending was larger than the contemporaneous decline in central government transfers.

Exhibit 1. Annual Change in Transfer Receipts and Subnational Expenditure, 2022–2025

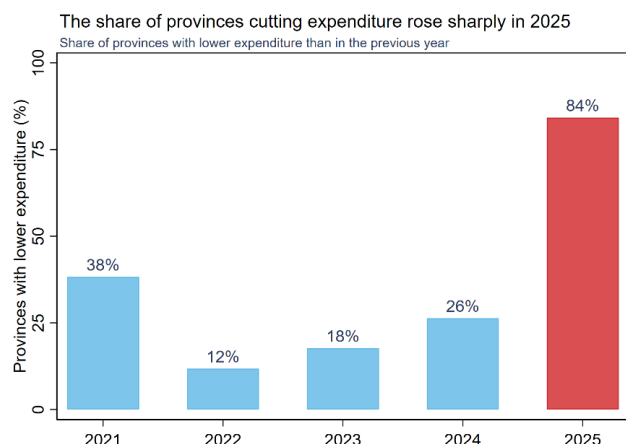


Sources: DGFB Ministry of Finance (consolidated realised regional budgets), authors' calculations.

Test 2: The Breadth of The Contraction

A national aggregate can be generated by sharp contractions in a small number of large provinces. To distinguish between a broad-based shift and a concentrated one, Exhibit 2 reports the proportion of provinces recording lower expenditure than in the preceding year

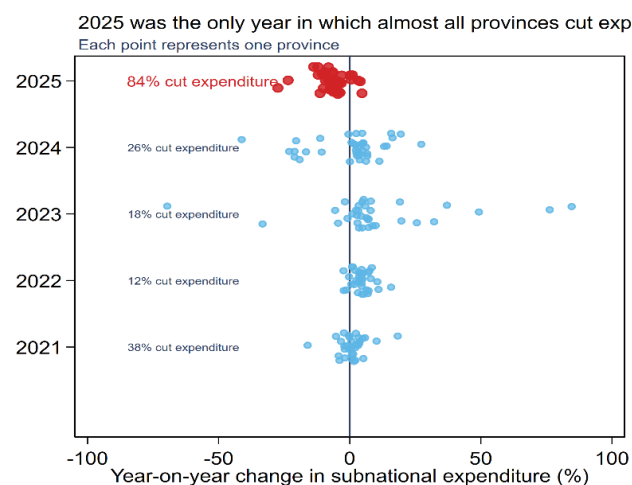
Exhibit 2. Share of Provinces Recording Negative Expenditure Growth, 2021-2025



Sources: DGFB Ministry of Finance (consolidated realised regional budgets), authors' calculations.

In 2025, 31 of 38 provinces, or 84 percent, spent less than in 2024. For comparison, the corresponding share ranged between 12 and 36 percent in the four preceding years, including 36 percent in 2021, the year of post-pandemic fiscal consolidation. The 2025 contraction has no precedent in the observation period along either dimension, depth or breadth

Exhibit 3. Distribution of Subnational Expenditure Growth Across Provinces, 2021-2025



Sources: DGFB Ministry of Finance, authors' calculations. Each point represents one province.

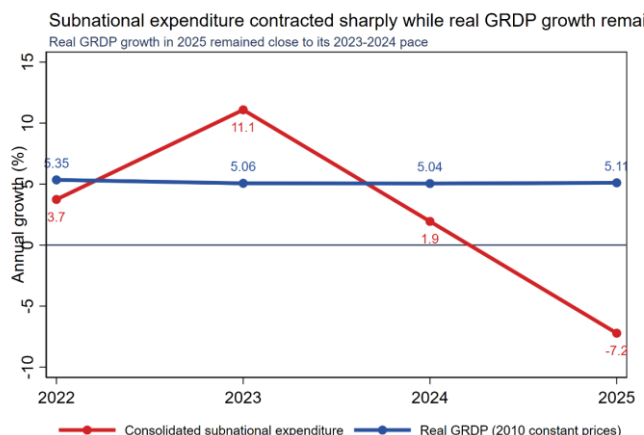
Exhibit 3 clarifies the nature of the shift. The entire distribution moves to the left in 2025. The median falls from 3.6 percent in 2024 to minus 6.4 percent. The tenth percentile stands at minus 12.1 percent and the ninetieth percentile at 0.7 percent, so that even the best-performing provinces record essentially no growth. The deepest contractions are recorded in Papua Pegunungan at minus 27.4 percent and DKI Jakarta at minus 23.5 percent

The two series move independently. Expenditure swings from growth of 2.5 percent in 2024 to a contraction of 7.2 percent in 2025, a reversal of 9.7 percentage points. Over the same period aggregate real GRDP growth is essentially unchanged: 5.07 percent in 2023, 5.06 percent in 2024, and 5.11 percent in 2025.

Test 3: The Real-Sector Counterpart

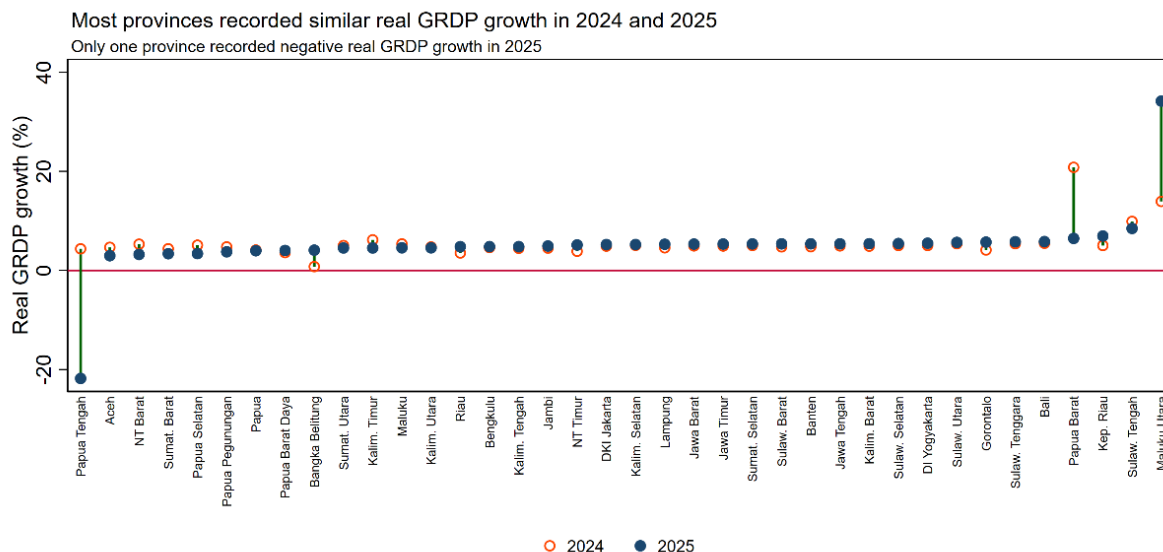
The question of greatest policy relevance is whether an expenditure contraction of Rp96.1 trillion is visible in regional economic activity. Exhibit 4 places consolidated expenditure growth alongside aggregate real GRDP growth for the same 38 provinces.

Exhibit 4. Subnational Expenditure Growth and Aggregate Real GRDP Growth, 2022-2025



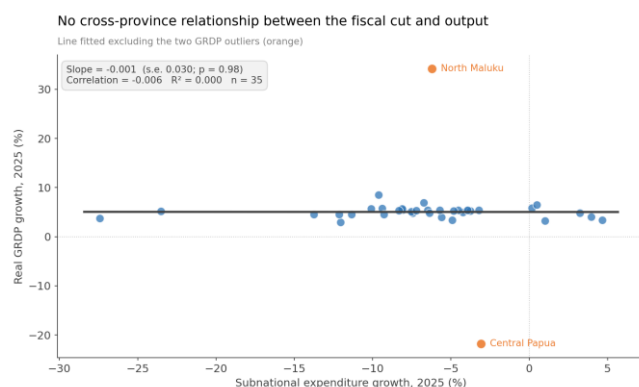
Sources: DGFB Ministry of Finance and Statistics Indonesia (2010 Series), authors' calculations.

The pattern is not confined to the aggregate. Most provinces shift very little between the two years. Of 38 provinces, only one records negative GRDP growth in 2025, while the median provincial growth rate rises slightly from 4.93 percent to 5.22 percent. The largest movements occur in the two outlier provinces, and bear no relation to the depth of their expenditure contraction.

Exhibit 5. Real GRDP Growth by Province, 2024 and 2025


Sources: Statistics Indonesia (2010 Series), authors' calculations. Provinces are ordered by 2025 growth.

The fitted line in Exhibit 6 is essentially flat. The absence of a visible response in aggregate GRDP, however, does not imply that every part of the regional economy is unaffected. Aggregate output can mask offsetting sectoral movements, particularly when an adjustment is recent and concentrated in public spending. The next step is therefore to ask whether the 2025 retrenchment appears differently across sectors rather than moving directly from headline GRDP to a single financial outcome.

Exhibit 6. Real GRDP Growth and Expenditure Growth Across Provinces, 2025


Sources: DGFB Ministry of Finance and Statistics Indonesia, authors' calculations. Orange markers denote the two provinces with extreme GRDP growth.

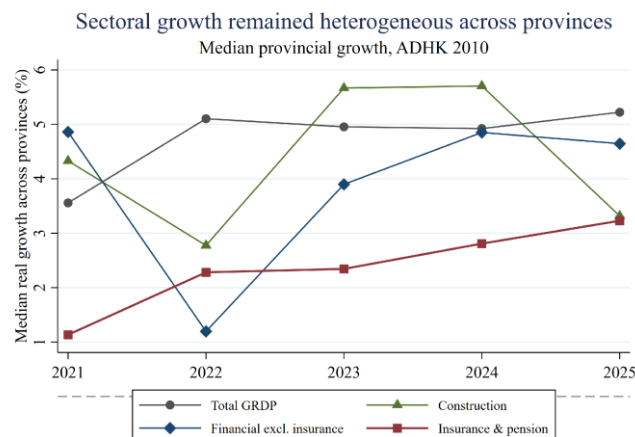
From Aggregate Resilience to Sectoral Adjustment

Aggregate resilience does not imply uniform sectoral resilience. A reduction in regional spending can affect industries differently depending on their exposure to public investment, household income, corporate cash flow, and local financial conditions. Construction provides a useful real-sector benchmark because it is more plausibly exposed to government expenditure and public investment, while financial activity excluding insurance provides a broader financial-sector comparator.

The choice of insurance is also motivated by the focus of this study on financial-sector implications. It should therefore be interpreted as a sectoral case study rather than as evidence that insurance is uniquely exposed to regional fiscal adjustment. The insurance measure is provincial PDRB for Insurance and Pension Funds at constant 2010 prices. It captures real sectoral value added rather than premiums, policy purchases, claims, or insurance penetration directly.

Test 4: How Broad Was Sectoral Weakness in 2025?

The sectoral comparison reveals an important distinction between the breadth and the pace of growth. Median provincial real GRDP growth increased from 4.92 percent in 2024 to 5.22 percent in 2025. Construction, by contrast, slowed from a median of 5.71 percent to 3.32 percent. Financial activity excluding insurance also eased, from 4.85 percent to 4.65 percent, while median insurance and pension-fund growth edged up from 2.81 percent to 3.23 percent.

Exhibit 7. Median Provincial Real Growth by Sector, 2021-2025


Sources: Statistics Indonesia (2010 Series); authors' calculations.

Note: Sectoral growth is calculated from provincial PDRB at constant 2010 prices. Financial activity excluding insurance equals BPS sector K minus K.2.

The cross-sectional breadth of weakness tells a sharper story. In 2025, only 2.7 percent of comparable provinces recorded negative total GRDP growth, but 24.3 percent recorded negative construction growth and 16.2 percent recorded negative growth in financial activity excluding insurance. Insurance and pension funds were the exception: none of the 38 comparable provinces recorded negative real growth. The sector was therefore resilient in the breadth of positive growth, even though its median growth rate remained below both total GRDP and broader financial activity.

Test 5: Did Deeper TKD Contractions Correspond to Weaker Sectoral Growth?

The answer is broadly no in the 2025 cross-section. The relationship between realised TKD growth and total GRDP growth is nearly flat, with an OLS slope of -0.044. The corresponding slopes are 0.009 for construction, 0.047 for financial activity excluding insurance, and 0.104 for insurance and pension funds. None of the four relationships is precisely estimated in 2025. The weak TKD-insurance relationship is therefore not an isolated result: the magnitude of the realised transfer decline has little systematic cross-province relationship with contemporaneous sectoral growth across the benchmarks considered here.

Table 2. Sectoral Growth and Its Cross-Province Relationship with TKD Growth, 2025

Sector	Mean growth	Median growth	Negative share	Corr. with TKD	Ordinary Least Square (OLS) beta	p-value
Total GRDP	5.098	5.223	2.703	-0.046	-0.044	0.704
Construction	3.107	3.316	24.324	0.016	0.009	0.907
Financial excl. insurance	4.146	4.646	16.216	0.075	0.047	0.722
Insurance & pension	3.937	3.229	0.000	0.191	0.104	0.414

Notes: N = 38, growth rates and negative shares are in percent. OLS beta is the slope from a cross-sectional regression of sector growth on realised TKD growth with robust standard errors. Values reproduce the sector-benchmark output without re-estimation.

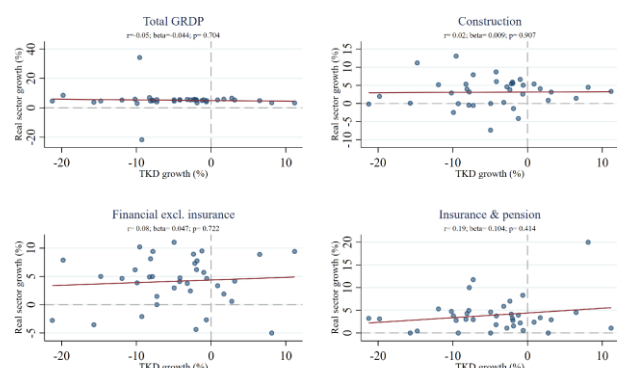
Insurance as a Financial-Sector Case Study

The absence of negative insurance growth across provinces should not be interpreted as exceptional sectoral expansion. Insurance and pension-fund growth was lower than total GRDP growth in 28 of 38 provinces, with a median insurance-minus-GRDP growth gap of -1.76 percentage points. The sector remained positive everywhere, but generally expanded more slowly than the broader regional economy.

Exhibit 8. TKD Growth and Sectoral Activity Across Provinces, 2025

2025 TKD adjustment and sectoral activity

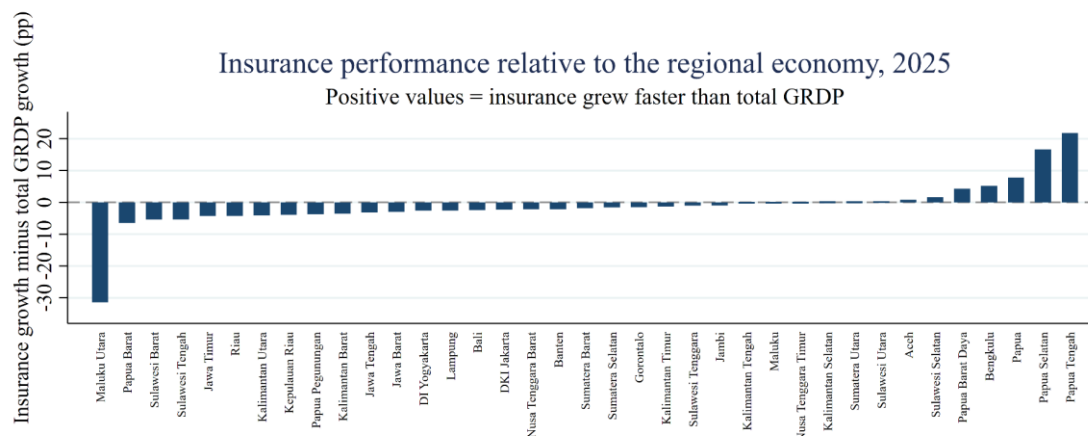
Same fiscal shock, different sectoral lenses



Bangka Belitung excluded. Associations are descriptive, not causal.

Sources: Directorate General of Fiscal Balance, Ministry of Finance; Statistics Indonesia; authors' calculations.

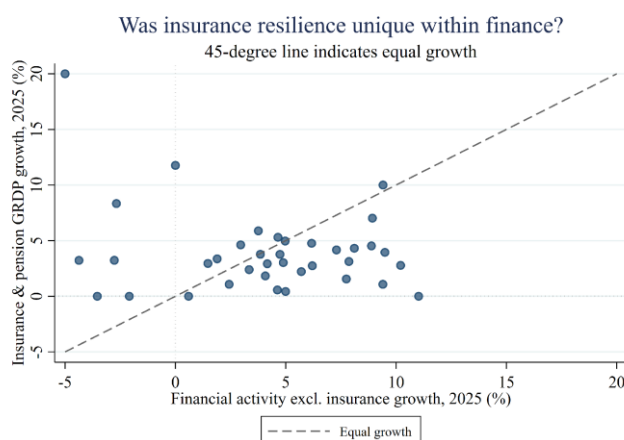
Note: All relationships are descriptive.

Exhibit 9. Insurance Growth Relative to Total GRDP Growth Across Provinces, 2025

Sources: Statistics Indonesia (2010 Series); authors' calculations.

Note: The 45-degree line denotes equal growth in insurance and total GRDP. Observations above the line indicate insurance outperformance.

The same pattern is visible within the financial sector (exhibit 10). Insurance and pension-fund growth was lower than financial activity excluding insurance in 24 of 38 provinces, with a median shortfall of 1.11 percentage points. This reinforces the view that insurance resilience in 2025 was broad rather than exceptional: real value added remained positive across all provinces, but insurance generally did not grow faster than the rest of the financial sector.

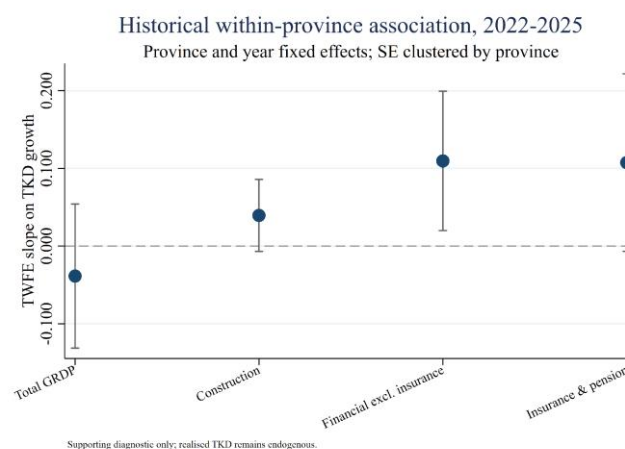
Exhibit 10. Insurance Growth Relative to Other Financial Activity Across Provinces, 2025

Sources: Statistics Indonesia (2010 Series); authors' calculations.

Note: Financial activity excluding insurance is constructed as BPS sector K minus K.2. The 45-degree line denotes equal growth.

Historical Context: Does the Relationship Look Different Over Time?

The short 2022-2025 panel provides a useful historical benchmark, although it should not be treated as causal evidence. After accounting for province and year fixed effects, the estimated TKD-growth coefficient is -0.039 for total GRDP, 0.039 for construction, 0.110 for financial activity excluding insurance, and 0.107 for insurance and pension funds. The broader financial-sector coefficient is the most precisely estimated, while the insurance estimate is positive but only weakly estimated. This pattern is more consistent with modest positive co-movement in financial activity than with a strong substitution mechanism in which lower public transfers are immediately offset by stronger private insurance activity

Exhibit 11. Pooled Province- and Year-Adjusted TKD-Sector Associations, 2022-2025

Sources: Directorate General of Fiscal Balance, Ministry of Finance; Statistics Indonesia; authors' calculations.

Note: Coefficients come from descriptive regressions with province and year fixed effects and standard errors clustered by province. Realised TKD remains endogenous.

How Should the Sectoral and Insurance Results Be Read?

Taken together, the evidence points to uneven short-run transmission beyond regional budgets. The 2025 fiscal adjustment is clearly visible in realised subnational spending, while aggregate GRDP remains broadly stable. Beneath that aggregate, however, sectoral outcomes differ: construction records the broadest incidence of negative growth among the benchmarks considered, broader financial activity remains positive in most provinces, and insurance and pension-fund value added stays non-negative in all comparable provinces.

For insurance specifically, resilience should be interpreted narrowly. The sector avoided a broad contraction, but it did not generally outperform the regional economy or other financial activity. This distinction matters because a positive growth rate does not by itself imply that insurance demand strengthened in response to fiscal retrenchment. The PDRB indicator measures real value added generated by insurance and pension-fund activities, not household insurance purchases, premiums, claims, or policy counts.

Several mechanisms could produce the observed pattern. Insurance contracts and premium payments may adjust with a lag, while financial-sector activity can depend more on national income, interest rates, corporate activity, and distribution networks than on contemporaneous changes in a province's realised transfers. The composition of the fiscal adjustment may also matter: transfer reductions concentrated in spending categories with limited direct links to insured households and firms need not produce an immediate movement in insurance-sector value added.

The broader implication is that the 2025 transfer adjustment appears to have transmitted quickly into regional budgets, but its same-year footprint beyond the public-spending channel is heterogeneous rather than uniform. Moreover, provinces with deeper realised TKD contractions did not systematically record weaker growth in aggregate GRDP, construction, broader financial activity, or insurance. Any wider transmission may therefore be delayed, mediated by the composition of spending, or offset by other regional and national forces during 2025.

These relationships are descriptive rather than causal. Realised TKD can respond to the same economic conditions that affect sectoral activity, and the available annual window is short. The sectoral scatterplots and pooled regressions are therefore best interpreted as evidence on contemporaneous co-movement and resilience, not as estimates of sector-specific fiscal multipliers.

Conclusion and Implications for the Insurance Industry

The 2025 fiscal retrenchment transmitted strongly into regional government spending. Realised TKD declined by 4.9%, while consolidated subnational expenditure fell even more sharply by 7.2%. The contraction was also unusually broad, with 31 of 38 provinces recording lower expenditure than in 2024. However, this substantial fiscal contraction did not translate directly into weaker aggregate regional economic growth. Real GRDP growth remained broadly stable at around 5.1%, suggesting that the immediate economic effects of fiscal tightening were uneven across sectors rather than visible in headline regional growth.

The sectoral evidence reinforces this interpretation. Construction, which is relatively exposed to government expenditure and public investment, experienced a marked slowdown, with median provincial growth declining from 5.71% in 2024 to 3.32% in 2025 and around one-quarter of provinces recording negative growth. Financial activity excluding insurance was more resilient, while insurance and pension-fund activity remained positive across all provinces.

Nevertheless, insurance resilience should not be interpreted as exceptional performance: insurance grew more slowly than total GRDP in 28 of 38 provinces and more slowly than other financial activities in 24 provinces. The evidence therefore points to broad resilience of insurance rather than an acceleration of insurance activity following fiscal retrenchment.

For the insurance industry, these findings suggest that headline regional economic growth may provide an incomplete picture of fiscal-related risk. A province can continue to record relatively stable GRDP growth while sectors with greater exposure to public expenditure, particularly construction, experience considerable weakening. Insurers should therefore complement regional macroeconomic indicators with information on the composition and realisation of government expenditure and the performance of sectors that depend heavily on public projects. At the same time, the results do not establish that premiums, claims, or insurance profitability were unaffected, since the insurance indicator used in the study measures sectoral real value added rather than insurance purchases, premiums, claims, or policy counts.

The implications may be particularly important for project guarantee programs. Fiscal tightening can reduce or delay regional expenditure and weaken construction activity even when overall regional economic growth remains stable. This can subsequently affect project execution, contractor cash flows, payment capacity, and ultimately the risk profile of guarantees associated with government-related projects. For project-guarantee underwriting and portfolio monitoring, indicators such as TKD realisation, APBD expenditure and capital spending, project postponements, contractor dependence on government contracts, payment delays, and regional construction performance may therefore provide more relevant early-warning signals than headline GRDP alone.

The study does not demonstrate that fiscal retrenchment caused higher contractor defaults or project-guarantee claims. Establishing that relationship would require project- and guarantee-level data. Nevertheless, the results provide a clear basis for further analysis linking regional fiscal conditions, construction activity, contractor financial performance, and guarantee claims. Such an extension would allow fiscal indicators to be incorporated more directly into risk assessment and early-warning systems for project guarantee portfolios.

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