

## **Do Village Funds Stimulate Micro and Small Industrial Activity? Evidence from Indonesia**

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### **Abstract**

Village Funds are a fiscal transfer instrument designed to strengthen rural development and community empowerment, including promoting job creation and enhancing local economic activities. However, empirical evidence on the extent to which Village Funds are effectively translated into productive economic growth at the village level remains limited. Most previous studies have focused on the impact of Village Funds on physical infrastructure development, village institutions, or aggregate welfare indicators, while their effect on expanding the base of micro and small enterprises has received relatively little attention.

This study aims to examine the impact of Village Funds on the growth of micro and small enterprises in rural Indonesia, proxied by the number of micro and small industries (MSIs). Specifically, the study investigates whether changes in the intensity of Village Funds over time are associated with changes in the number of MSIs at the village level, after controlling for both time-invariant village characteristics and time-varying supporting factors.

The study employs a quantitative approach using village-level panel data for 2018 and 2021, combining data from the Village Potential Statistics (PODES) and Village Fund allocations. The dependent variable is the number of MSIs, while the key independent variable is Village Funds measured in per capita or per household terms. The main estimation uses a Fixed Effects model, which is equivalent to a First Difference approach in a two-period panel, to control for unobserved time-invariant heterogeneity at the village level. As a robustness check, the study also applies a Poisson Pseudo-Maximum Likelihood (PPML) model with fixed effects, considering that the MSI variable is count data with potential excess zeros.

This study is expected to contribute to the empirical literature on the effectiveness of Village Funds as a driver of local economic development, as well as provide policy insights for improving the allocation of village spending toward more productive uses that support the growth of micro and small enterprises in



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Indonesia.

**Keywords:** Village Funds; Micro and Small Enterprises; Rural Development; Local Economic Growth; Fiscal Transfer