

# Effect of Fiscal Decentralization, Provincial Minimum Wage, and Local Revenue on Income Inequality in Islamic Economic Perspective

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## Abstract

This study aims to analyze the effect of fiscal decentralization, provincial minimum wages, and local revenue (PAD) on income inequality in the provinces on the island of Sumatra in the period 2018-2024, as well as review the findings in the perspective of Islamic economics. Income inequality in Indonesia, especially in the Sumatra region, is still a significant issue despite various decentralization policies and increased minimum wages. This research method uses a quantitative approach of panel data, which combines time series and cross section data. Data is obtained from the Central Bureau of Statistics and other reliable sources. The analysis was conducted using panel data regression model through Random Effect Model (REM) approach selected based on the results of Chow, Hausman, and Lagrange Multiplier tests. All testing was done using EViews software. The results of the analysis show that simultaneously, fiscal decentralization, provincial minimum wages, and PAD have a significant effect on income inequality, although the direction and significance vary between variables and provinces. In the Islamic economic perspective, the reduction of income inequality is part of the principle of distributive justice which is required to ensure welfare and avoid the accumulation of wealth in certain groups. Therefore, the implementation of fiscal and labor policies is expected to be in line with Islamic values, such as justice, equity, and alignment with the weak.

## Keywords

Fiscal decentralization; provincial Minimum Wages; local revenue (PAD); income inequality

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## 1. INTRODUCTION

Economic development is defined as a multi-dimensional process that focuses not only on economic growth, but also on structural, social, and institutional transformations to achieve overall improvements in people's quality of life (Todaro, M., & Smith, 2015). In this context, economic development and income equity are two closely interrelated main pillars, which aim to improve the welfare of the people at large through the optimal utilization of resources. This effort is measured not only from an increase in national income or a high rate of economic growth, but also from the extent to

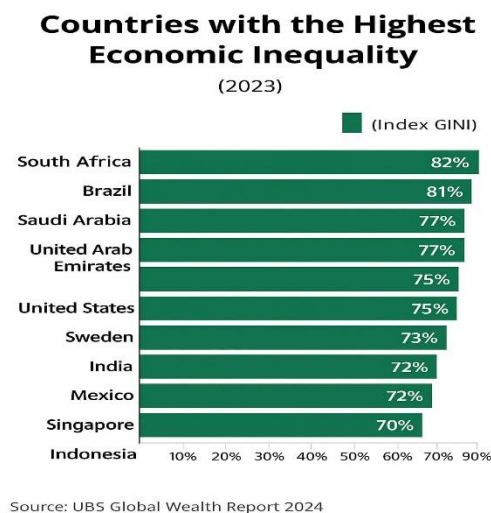


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which development results are enjoyed fairly by all levels of society (Darwin Lie et al., 2022).

Indonesia is arguably successful in increasing economic growth, as one of the developing countries that have a high level of economic growth but in fact this is not accompanied by a reduction in income inequality that occurs in Indonesia. According to the UBS Global Wealth Report, economic inequality in Indonesia in 2023 is quite high. Indonesia even entered the top 10 countries with the worst economic inequality in the world, judged by the Gini index.



**Figure 1 countries with economic inequality in the world**

Source: good stats.id

According to the World Inequality Lab, in 2022, the upper 1% of the population in Indonesia controlled 30.16% of the total national household assets. The figure even increased from 2021 which was 25.75%. The phenomenon of increasing asset ownership by the top 1% of the population in Indonesia, which increased from 25.75% in 2021 to 30.16% in 2022 according to the World Inequality Lab, indicates a structural imbalance in the economy. This increase can be analyzed as a result of various factors, including the rapid growth of the financial sector, the concentration of ownership of productive assets such as stocks and property, as well as fiscal policies that tend to benefit investors and capital owners. The implications of this inequality are significant: in addition to creating uncertainty for the majority of people, it can also hinder social mobility, weaken the purchasing power of the wider community, and potentially trigger socio-political instability. Therefore, policies in favor of equitable distribution of income and assets are crucial. The government needs to consider policy instruments such as progressive taxes on wealth, increased access to education and capital for the lower middle class, and tighter regulation of financial markets to create more inclusive and sustainable economic growth for all levels of society.

The inequality of income distribution reflected in the Gini coefficient is one of the development

focuses emphasized by the government of Indonesia every year (Amir Husni et al., 2023). The Gini coefficient is used as a tool to measure the level of income inequality among the population. The higher the value of the Gini coefficient in a region, the greater the inequality that occurs, indicating the existence of inequality in the distribution of income between high and low income groups. The Gini coefficient is one of the main indicators used by the Indonesian government to measure and monitor income distribution inequality among the population. Mathematically, the Gini coefficient is calculated from the area between the Lorenz curve and the perfect equality line, with values ranging from 0 (perfect equality, where everyone has the same income) to 1 (total inequality, where one person controls all income). The trend of the National Gini coefficient in Indonesia over the past five to ten years shows fluctuations, but in general, there has been a slow improvement. As in the Central Statistics Agency (BPS) data show that Indonesia's Gini coefficient gradually decreased from 0.41 in 2014 to around 0.388 in 2023, although it had increased during the pandemic. This decline reflects the success of various government programs in reducing inequality, such as social assistance and economic empowerment programs, but the challenge of achieving better levels of equity remains great.

Sumatra island is the third largest island in Indonesia and has tremendous natural resource potential. The island consists of 10 provinces, making Sumatra the island with the most provinces. The provinces have different geographical conditions and resources, which affect the differences in the economy and welfare of the people in each state. Potential resources and geographical conditions are different in each region is the cause of inequality (Mardhian et al., 2023). Income inequality is often the result of inequality in the process of economic development, caused by structural and geographical factors. One of the main causes is the uneven concentration of economic activity, where most investment, industry and job opportunities are concentrated in just a few regions. This creates significant disparities in terms of infrastructure, quality of education, and access to capital between regions. On the other hand, less developed regions experience a scarcity of investment and opportunities, which ultimately limits the potential of the local economy and causes people's incomes in the region to tend to stagnate. Thus, this unevenness is not only reflected in the Gini coefficient figures, but also from the daily reality that shows that development and prosperity are not enjoyed equally by the whole society.

**Table 1**  
**Gini Ratio of 10 provinces on the island of Sumatra in 2018 – 2024**

Provinces	Gini Ratio 2018 – 2024						
	2018	2019	2020	2021	2022	2023	2024
Aceh	0.318	0.321	0.319	0.323	0.291	0.296	0.294
Sumatera Utara	0.311	0.315	0.314	0.313	0.326	0.309	0.306
Sumatera Barat	0.305	0.307	0.301	0.300	0.292	0.280	0.287

Riau	0.347	0.331	0.321	0.327	0.323	0.324	0.306
Kep. Riau	0.339	0.337	0.334	0.339	0.325	0.340	0.357
Jambi	0.335	0.324	0.316	0.315	0.335	0.343	0.315
Bengkulu	0.355	0.329	0.323	0.321	0.315	0.333	0.343
Sumatera Selatan	0.341	0.339	0.338	0.340	0.330	0.338	0.331
Bangka Belitung	0.272	0.262	0.257	0.247	0.255	0.245	0.235
Lampung	0.326	0.331	0.320	0.314	0.313	0.324	0.301

Source: Central Bureau Of Statistics 2024

Based on the above data, fluctuations in the Gini coefficient on the island of Sumatra from 2018 to 2024, there is a significant disparity between provinces. Data analysis shows that the Riau Islands recorded the highest Gini Coefficient in Sumatra in 2024, reaching 0.357, with significant fluctuations during that period. This indicates that although the province has high economic growth, the benefits are uneven, most likely due to the concentration of industry and investment in certain sectors, such as tourism and the processing industry. In contrast, the Bangka Belitung Islands Province shows the lowest average Gini Coefficient in Sumatra, which is 0.235 in 2024. This stability and lower levels of inequality may be due to its more homogeneous economic structure and being dominated by sectors that provide more equitable income to society, such as tin mining and plantations. This phenomenon confirms that the economic development strategies implemented by each province have a direct impact on the level of income inequality, which needs to be a concern in formulating more inclusive and sustainable policies in the future.

One of the efforts that can be used to overcome income inequality between regions is the application of regional autonomy in the form of fiscal decentralization (Santi & Iskandar, 2021). Decentralization is a policy of various dimensions including fiscal, administrative and political elements where the implementation is carried out at various levels of government that are interconnected with one another. Decentralization, democratization and globalization are the necessary regional rearrangements, namely strategies, work environments, management, cultures and systems supported by professionalism, accountability, principles of Justice, participation of all parties, transparency and accountability. The division of authority to the regions is also a division of Finance between levels of government called fiscal decentralization. The division of authority regarding finance based on the tasks performed is called the concept of “money follow function” .

The effectiveness of fiscal decentralization is strongly influenced by the capacity of local governments to utilize existing financial resources. Research shows that regions that are able to maximize the potential of fiscal decentralization generally have better economic growth and lower income disparities (Agastha & Rahman, 2025). Conversely, regions that are still dependent on central funds often face difficulties in achieving development targets. Fiscal decentralization is a policy that

empowers local governments to manage financial resources more independently, with the aim of improving the efficiency of public services and encouraging equitable development (Astriana & Khoirunurrofik, 2024). One of the main indicators in the implementation of fiscal decentralization in Indonesia is the General Allocation Fund (DAU), which is a transfer fund from the central government to the regions that aims to fund routine spending needs and reduce fiscal inequality between regions (Hasan, 2020). Theoretically, the DAU should help regions with low fiscal capacity to run government functions optimally.

But in reality, DAU distribution has not been fully effective in addressing income inequality between regions. Many regions continue to experience economic disparities despite receiving large amounts of DAU transfers each year. This inequality can be caused by various factors such as the low effectiveness of the use of funds, the weak capacity of local budget management, and the lack of accountability in the allocation of public spending. This raises important questions about the extent of the DAU's role in realizing the main goal of fiscal decentralization, namely economic justice and equity (Lobubun et al., 2022).

The phenomenon of income inequality that still occurs in various regions of Indonesia, especially between developed and underdeveloped regions, shows that fiscal intervention through DAU has not had an optimal impact. This inequality not only has an impact on people's welfare, but also widens the development gap between regions. Therefore, it is important to re-examine how fiscal transfer policies such as DAU can be directed more effectively in order to strengthen regional fiscal capacity and reduce income inequality in a sustainable manner.

**Table 2**  
**The amount of DAU on the island of Sumatra in 2018-2024**

Provinces	2018	2019	2020	2021	2022	2023	2024
Sumatera Selatan	985.542.760,00	931.915.470,00	1.071.421.391,00	1.697.897.817,00	1.697.762.032,00	1.743.742.960,00	Rp1.568.602.615,00
Bengkulu	Rp955.095.187,00	Rp1.046.080.820,00	Rp1.070.751.292,00	Rp1.301.546.123,00	Rp1.300.982.321,00	Rp1.334.182.431,00	Rp1.219.949.535,00
Bangka Belitung	806.820.146,00	897.887.443,00	905.526.208,00	1.035.119.230,00	1.018.673.218,00	1.046.862.622,00	942.308.451,00
Lampung	1.136.053.041,00	1.097.129.439,00	1.321.679.032,00	1.851.595.354,00	1.854.701.094,00	1.906.780.297,00	1.732.551.921,00
Jambi	948.337.712,00	1.009.165.864,00	1.070.452.478,00	1.397.912.161,00	1.399.367.134,00	1.433.203.410,00	1.288.418.327,00
Sumatera Utara	1.349.132.276,00	1.139.261.371,00	1.604.505.673,00	2.629.224.545,00	2.629.224.545,00	2.713.750.553,00	2.713.750.553,00
Sumatera Barat	1.129.886.306,00	1.221.128.606,00	1.261.915.864,00	2.014.646.639,00	2.014.646.639,00	2.076.398.191,00	1.891.323.979,00
Aceh	1.202.000.000,00	1.238.000.000,00	1.264.000.000,00	1.920.000.000,00	206.026.000,00	2.322.270.000,00	1.956.490.000,00
Kep Riau	820.984.584,00	654.220.000,00	738.379.000,00	1.457.997.000,00	1.434.458.000,00	1.548.578.928,00	1.432.349.278,00
Riau	1.607.851.000,00	1.728.537.000,00	1.913.695.540,00	2.000.906.541,00	1.762.803.611,00	956.328.413,00	1.044.825.349,00

Source: Central Bureau of Statistics, processed by the author

Based on data from the General Allocation Fund (DAU) from 2018 to 2024 in several provinces in

Sumatra, it can be seen that the DAU allocation is relatively stable from year to year with fluctuations that are not too significant. Provinces such as Lampung and South Sumatra consistently receive fairly high DAU allocations, while provinces such as West Sumatra and North Sumatra tend to receive lower allocations compared to other provinces. This reflects the fiscal inequality between regions that still occurs even though the central government has routinely distributed DAU. Stable allocation of DAU does not necessarily guarantee the achievement of equitable development, because the effectiveness of the use of funds is also highly dependent on the ability of local government governance respectively. Therefore, it is important to reevaluate not only the size of allocations, but also their impact on reducing interregional income inequality.

In addition to fiscal decentralization, income inequality can also be overcome by increasing the minimum wage in a province in the context of income equalization (Nisa et al., 2025). The minimum wage policy aims to ensure the income of workers so that it is not lower than a certain level, as well as to prevent significant differences in the distribution of income (Heni Meidiyan et al., 2025). Thus, the minimum wage policy plays a role in suppressing income inequality and improving the welfare of workers or laborers (Astriana & Khoirunurrofik, 2024). the development of the provincial Minimum wage (UMP) on the island of Sumatra can be seen in the table below.

**Table 3**  
**Magnitude of UMP on the island of Sumatra**

Provinces	UMP on the island of Sumatra in 2018 – 2024						
	2018	2019	2020	2021	2022	2023	2024
Aceh	2.700.000	2.916.810	3.165.031	3.165.031	3.166.460	3.413.666	3.460.672
Sumatera Utara	2.132.189	2.303.403	2.499.423	2.499.423	2.522.610	2.710.493	2.809.915
Sumatera Barat	2.119.067	2.289.220	2.484.041	2.484.041	2.512.539	2.742.476	2.811.449
Riau	2.464.154	2.662.026	2.888.564	2.888.564	2.938.564	3.191.62	3.294.625
Kep. Riau	2.563.875	2.769.754	3.005.460	3.005.460	3.050.172	3.279.000	3.402.492
Jambi	2.243.719	2.423.889	2.630.162	2.630.162	2.698.941	2.943.000	3.037.121
Bengkulu	1.888.741	2.040.407	2.213.604	2.215.000	2.238.094	2.400.000	2.507.079
Sumatera Selatan	2.595.995	2.804.453	3.043.111	3.144.446	3.144.446	3.404.177	3.456.874
Bangka Belitung	2.755.444	2.976.706	3.230.024	3.230.024	3.264.884	3.498.479	3.640.000
Lampung	2.074.673	2.241.270	2.432.002	2.432.002	2.440.486	2.633.284	2.7166.497

Source: secondary Data, processed by the author

Based on Table 3 on the provincial Minimum wage (UMP) on the island of Sumatra, there are significant differences between regions, which are directly related to the issue of income inequality. Analysis of UMP data from 2018 to 2024 shows that UMP fluctuations are not always positively

correlated with improvements in the Gini ratio. For example, although the Bangka Belitung Islands province has the largest UMP in Sumatra in 2024, followed by Aceh and South Sumatra, it needs to be further evaluated to what extent the increase in UMP contributes to the decrease in the GINI ratio in those provinces. On the other hand, provinces with the lowest UMP, such as Bengkulu, Lampung, and North Sumatra, tend to experience greater challenges in reducing income inequality. The increasing trend of UMP varying between provinces indicates that regional wage policies need to be adapted to the economic conditions and levels of inequality in each region to ensure that wage increases are actually able to improve welfare and effectively reduce income disparities.

The minimum wage is one of the instruments of government policy that aims to protect workers from exploitation and ensure a decent income to meet the minimum living needs (Raharjo et al., 2025). In practice, the establishment of a minimum wage is often influenced by diverse regional economic conditions, thus creating differences between regions that can have an impact on income inequality. This distinction is even more complex when it comes to fiscal decentralization, which is the process of delegating financial and decision-making authority from the central government to local governments (Wulandari et al., 2019). Through fiscal decentralization, each region has autonomy to design and implement economic policies including in terms of resource management and public spending allocation, which in turn can strengthen or widen economic inequality between regions depending on the fiscal capacity and governance of each region (Nopia Yudiastuti et al., 2025).

The provincial Minimum wage (UMP) is a government policy instrument that aims to ensure minimum income standards for workers, while reducing economic inequality between individuals in a region (Salim & Hizkia, 2023). However, the determination of UMP is often inseparable from the economic conditions of each region that vary, both in terms of labor productivity, cost of living, and fiscal capacity. Local revenue (PAD) is a crucial indicator that reflects the financial independence of a province in financing development and public policies, including the determination of the provincial Minimum wage (UMP) (Dalisawintri et al., 2025). PAD is sourced from various sectors, not only local taxes, but also levies, the results of regional wealth management are separated, as well as other legitimate income. The relationship between PAD and income inequality, as measured by the Gini ratio, is particularly relevant for analysis. Regions with high PAD, such as the Riau Islands, often have more flexible budgets to invest in infrastructure and social programs, which could theoretically help reduce inequality. However, empirical data in Sumatra show that high PAD does not necessarily correlate directly with a low Gini ratio. For example, Riau Islands has a relatively large PAD but also a high Gini ratio. This indicates that the high PAD does not guarantee an even distribution of income; rather, it is the effectiveness of budget allocation and pro-equalization policies that are the main determining factors in overcoming economic inequality between regions (Feriyanto & Koriningpertiwi, 2019).

Various factors determine the process of regional economic development including local revenue (PAD) (Amdan & Sanjani, 2023). Local revenue (PAD) has a strategic role as a source of development funding derived from local potential, such as local taxes, levies, and the results of regional wealth management (Dahlia et al., 2024). PAD reflects the ability of local governments in mobilizing revenue to finance development programs, improve infrastructure, and create jobs (Handraini et al., 2024). Optimal PAD management can contribute significantly to economic growth, especially in encouraging local economic activity (Wahyuni Siregar et al., 2024).

**Table 4**  
**The amount of provincial PAD in Sumatra in 2018-2024**

Provinces	2018	2019	2020	2021	2022	2023	2024
Aceh	101,49	108.76	97.96	104.34	113.59	106.48	108,75
Sumatera Utara	98.37	75.97	92.69	106,87	106.44	91.96	116.16
Sumatera Barat	98.02	93.46	89.19	109.34	109.11	91.89	86.16
Riau	91.80	98.59	83.54	100.11	98.87	108.88	81.66
Kep.Riau	99.76	104.70	91.74	101,71	124.27	119.02	87.29
Jambi	110.84	108.29	92.19	122.31	121.51	92.74	82.31
Bengkulu	87.77	69.58	63.78	103.77	112.60	106.81	101.74
Sumatera Selatan	97.79	104.96	83.31	88.42	98.49	92.71	107.57
Bangka Belitung	109.57	101.19	70.92	119.52	133.88	97.52	79.81
Lampung	90.08	88.15	86.17	97.37	106.68	90.83	80.68

Source : DJPK kemenkeu

Based on data on local revenue (PAD) from 2018 to 2024 in several provinces of Sumatra, there are significant fluctuations from year to year. Some areas such as Bangka Belitung and Jambi showed fairly high PAD numbers at the beginning of the period, but experienced a sharp decline in subsequent years. On the other hand, provinces such as North Sumatra and Aceh show a more stable upward trend towards 2024. Interprovincial inequality is also evident, reflecting differences in fiscal capacity and effectiveness of regional financial management. This shows that the implementation of fiscal decentralization has not been evenly impacted, and still depends on the ability of each region to explore and manage its economic potential optimally.

All forms of regional potential are sought optimally to be managed in such a way as to be able to become a source of income/revenue and benefit the region itself. This is because local revenue is a pillar in regional funding in determining the ability of economic implementation as measured by the size of



the contribution made to the APBD. The greater the income obtained by local governments which means the contribution of PAD to the state budget is also greater (Gunawan & Suebah, 2022).

Increasing inequality causes various problems, if it continues to accumulate it can generate insecurity and generate various types of conflicts (RAHMAWATI et al., 2023). Conflicts can occur between communities, between regions or communities with the government and between the central government and local governments. In the perspective of Islamic economics, efforts to overcome inequality are by equitable distribution of property (Ali et al., 2024). As Allah says in the Qur'an surah al-Hashr (59) verse 7 which reads:

مَا أَفَاءَ اللَّهُ عَلَى رَسُولِهِ مِنْ أَهْلِ الْقُرَى فَلِلَّهِ وَلِلرَّسُولِ وَلِذِي الْقُرْبَىٰ وَالْيَتَامَىٰ وَالْمَسْكِينِ وَابْنِ السَّبِيلِ كَيْ لَا يَكُونَ دُولَةً ۚ بَيْنَ الْأَغْنِيَاءِ مِنْكُمْ ۚ وَمَا آتَاكُمُ الرَّسُولُ فَخُذُوهُ وَمَا نَهَاكُمْ عَنْهُ فَانْتَهُوا ۚ وَاتَّقُوا اللَّهَ إِنَّ اللَّهَ شَدِيدُ الْعِقَابِ ﴿٧﴾

*It means: "whatever booty (FA'i) Allah gives to His Messenger (of the property) from the inhabitants of the cities is for Allah, and for the messenger, relatives, orphans, the poor and those in transit, so that it does not circulate among the rich only and among you. Accept what the Messenger has given you, and what he has forbidden you. Indeed, Allah is severe in punishment." (Q. S. Al-Hashr [59] : 7)*

This verse is intended to emphasize that property is not only owned and controlled by a group of people only. Wealth does not accumulate in one group. Since Islam has established from the beginning that property has a social function, it recognizes property rights and prohibits monopolies, but it also requires that property be circulated in society so that it can be used by all members of society (MH et al., 2020). According to Islamic scholars and economic experts, such as Yusuf Al-Qardhawi, this verse becomes the theological basis for the obligation of wealth redistribution. Islam recognizes individual ownership and prohibits monopolies, but at the same time, requires that wealth continue to circulate in society through various instruments, such as zakat, Infaq, and Sadaqah. The goal is to ensure that all levels of society can enjoy economic benefits and prevent extreme inequality that can damage the social fabric (Aravik et al., 2022).

The relevant previous research is in the research conducted by (Febrianto et al., 2018) which has a positive and significant result of fiscal decentralization. While in a study conducted by (Sanas & Tobing, 2024), stated that fiscal decentralization has a positive and insignificant effect on income inequality. Then in the research of (Amali & Syafri, 2023) the minimum wage has a positive and significant effect on income inequality. While (Rifai & Rauf, 2022) the provincial minimum wage is negative and not significant to income inequality. Then a study conducted by (Finuliyah & Khusaini, 2022) stated that PAD has a positive and significant effect on income distribution inequality. Meanwhile, research conducted by Firdaus Finuliyah and Moh Khusaini stated that PAD does not affect inequality between

regions.

From the above problems, the researcher is interested in conducting further research, so the author is interested in taking the title “the effect of fiscal decentralization, provincial Minimum Wage, and local original income on income inequality of the Sumatera Island in the perspective of Islamic Economics in 2018-2024”.

## **2. METHODS**

The type of data used in this study is quantitative data presented in the form of numbers. This study used one dependent variable and three independent variables. The dependent variable in this study is income inequality while the independent variables in this study are fiscal decentralization, provincial Minimum Wage and local revenue. The type of data used is panel data. As for the data obtained from the Central Bureau of Statistics and reliable publications. This research will be conducted in 10 provinces of Sumatra. In order for the research method to be in line with what the researcher expects, the scope also includes fiscal decentralization data, provincial Minimum wages and local original income, where the data starts from 2018-2024. The 2018-2024 period was chosen because it covers a time span in which there have been various significant changes in fiscal policy and economic trends in Indonesia, such as the implementation of the Financial Relations Law between Central and local governments (HKPD law) and the impact of global economic fluctuations. In addition, the selection of this period is also based on the availability of consistent and complete panel data from the Central Statistics Agency (BPS) for all relevant research variables in 10 provinces on the island of Sumatra.

In this study, the population taken includes 10 provinces on the island of Sumatra. Because this study uses the entire province that is the object of study, the population is also sampled, so there is no further sampling process (Suriani et al., 2023). The method used is panel data, which is a combination of cross-section data with 10 provinces and time-series data for the period 2018-2024. This method is very relevant for this study because it allows dynamic analysis that can identify the causal relationship between the independent variable and the dependent variable. With the panel's data, researchers can see how changes in those variables from year to year affect income inequality, while controlling for the unique characteristics of each province that might affect outcomes. The main data sources are obtained from the publications of the Central Statistics Agency (BPS) and other trusted references, ensuring the accuracy and validity of the findings.

The method of data analysis in this study using econometric approach with software Eviews. The first step is to choose the most appropriate panel data regression model through the Chow Test, to compare the Common Effect (Pooled Least Square) model with the Fixed Effect. Then, the Hausman

test is used to determine the choice between Fixed Effect and Random Effect models. Next, the LaGrange Multiplier (LM) test is performed to choose between Common Effect and Random Effect models. After the best model is selected, a classical assumption test is carried out, including multicollinearity, heteroscedasticity, and autocorrelation tests, to ensure that the regression model used is unbiased and has valid results. Finally, the hypothesis test was conducted using the t test to test the significance of the influence of the independent variable partially and the F test to test the significance of the influence of the independent variable simultaneously.

**Table 5**  
**Operational Variables**

Research Variables	Definition	Units Of Measure	Sources
Income Inequality (Y)	Income inequality is one of the core problems in developing countries. The distribution of individual income itself is the measure most often used by economists to calculate the amount of income received by each individual or household (Anwar, 2023).	Gini Index	The Central Bureau Of Statistics
Fiscal Decentralization (X1)	Fiscal decentralization is a process of distributing budgets from higher levels of government to lower levels of government to support the functioning of a governmental task of public service, meaning that regions must be able to act locally but with national insight (Demora, 2017).	Billion (IDR)	The Central Bureau Of Statistics
Provincial Minimum Wage (X2)	The Minimum wage is the lowest monthly wage consisting of basic wages including fixed benefits. This wage is valid for those who are single and have a work experience of 0-1 years, serves as a safety net, is established through a governor's decree based on the recommendation of the wage board and is valid for 1 current year (Lokiman et al., 2014).	Rupiah (IDR)	The Central Bureau Of Statistics
Local Revenue (X3)	Local revenue (PAD) is all revenue derived from local economic resources. The PAD group is separated into four types of income, namely local taxes, regional levies, the results of Wealth Management belonging to the separated regions, and	Billion (IDR)	Directorate General Of Financial Balance

others legitimate PAD (Sri Mulyani & Ramdini, 2021).

Source: data processed by the author, 2025

### 3. FINDINGS AND DISCUSSION

#### 3.1 Panel Data Model Selection

##### 1. Chow Test

This test is used for selection between fixed effect and common effect models. Chow test is a test to see the result of f to choose a better model between common effect and fixed effect.

**Table 5**  
**Chow Test Results**

Effects Test	Statistic	d.f.	Prob.
Cross-section F	50.128666	(9,57)	0.0000
Cross-section Chi-square	153.141880	9	0.0000

Source: Output reviews 10 processed 2025

Based on the results of the Chow test, the value of Prob. Cross-Section F is 0.00 while The Chi-Squer value is 0.00. And the result shows that the probability value is less than 0.05 ( $< 0.05$ ) which means H0 is rejected and H1 is accepted. This shows that the fixed effect (FEM) model is better than the common effect (CEM) model.

##### 2. Hausman Test

Hausman test is a statistical test to choose whether the model of Fixed Effect or Random Effect is most appropriate to use.

**Table 6**  
**Hausman Test Results**

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.221336	3	0.9741

Source: Output reviews 10 processed 2025

Based on the results of the hausman test obtained prob value of 0.9741 this means that the prob is greater than 0.05 ( $> 0.05$ ), then H0 accepted and H1 rejected. This test concluded that the estimation of the right model to be used in the regression analysis of panel data is the random effect model (REM) so

that the next test to determine the right model used in the regression of panel data is the Langrange Multipiller (LM) Test.

### 3. LaGrange Multiplier (LM)test

Lagrange Multiplier test is used for testing random effects based on the residual value of the common effect model (Suyadi et al., 2023).

**Table 7**  
**Lagrange Multiplier Test Results**

Null (no rand. effect) Alternative	Cross-section One-sided	Period One-sided	Both
<b>Honda</b>	<b>12.50650</b> (0.0000)	<b>-1.644012</b> (0.9499)	<b>7.680941</b> (0.0000)
<b>King-Wu</b>	<b>12.50650</b> (0.0000)	<b>-1.644012</b> (0.9499)	<b>6.636361</b> (0.0000)
<b>SLM</b>	<b>14.21155</b> (0.0000)	<b>-1.388057</b> (0.9174)	-- --
<b>GHM</b>	-- --	-- --	<b>156.4126</b> (0.0000)

Source: Output reviews 10 processed 2025

Based on the results of the test LaGrange multipler obtained Beauch pagan cross section value of 0.00 ( $< 0.05$ ). Then  $H_0$  is rejected and  $H_a$  is accepted which means that in the LaGrange multipiller test the selected model is a Random Effect Model (REM). It can be concluded that the appropriate model used in the regression analysis of panel data is the Random Effect Model.

### 3.2 Classical Assumption Test

This test is a statistical requirement that must be met in regression analysis using Ordinary Least Squares (OLS) method. The purpose of the classical assumption test in this study is to ensure that the selected Fixed effect model is the best analysis model in terms of estimation accuracy, unbiased, and consistency.

If the model used in panel data regression is Random Effect Model, then there is no need for heteroscedasticity test. In the classical assumption test using panel data if the best model chosen is random effect model then heteroscedasticity test does not need to be done. This can be concluded because the random effect model has used the Generallized Least Square (GLS) method so that in this study there is no need to test heteroscedasticity because the best model used is the random effect model (Gujarati, 2009). So the classic assumption test conducted in this study is multicollinearity test. If the correlation coefficient between independent variables shows a number below 0.80, this is one of the strong indications of being free from the symptoms of multicollinearity. On the contrary, if the figure is above 0.80 indicates an indication that the affected multicolienarity symptoms. Testing can be seen as follows:

**Table 8**  
**Multicollinearity Test Results**

	KP	DF	UMP	PAD
KP	1.000000	0.072492	-0.306252	-0.041099
DF	0.072492	1.000000	0.050786	0.097473
UMP	-0.306252	0.050786	1.000000	0.154301
PAD	-0.041099	0.097473	0.154301	1.000000

Source: Output reviews 10 processed 2025

Based on the results of multicollinearity test conducted using correlation analysis between independent variables, it is known that the correlation value between variables X1 (DF), X2 (UMP), X3 (PAD) are all below 0.80. This shows that there is no strong linear relationship between the three independent variables. Thus, it can be concluded that there is no multicollinearity in this regression model.

### 3.3 Interpretation Of Panel Data Regression

**Table 9**  
**Random Effect Model Test Results**

Variables	Coefficients	t-Statistic	Prob.
DF	3.92E-12	1.258.580	0.2126
UMP	-2.54E-08	-5.238019	0.0000
PAD	2.22E-05	0.249768	0.8035
C	0.376114	21.249768	0.0000
R-square	0.324537		
F-statistic	10.57023		
Prob. (F-statistic)	0.000009		

Source: Output reviews 10 processed 2025

Coefficient value of each variable where C is a constant value of 0.376114 while X1 is a fiscal decentralization variable with a coefficient of 3.92 E-08, X2 is a provincial Minimum wage variable with a coefficient of -2.54 E - 08, and X3 is a variable of local revenue with a coefficient of 2.22 E-05, then in:

$$KP = 0.376114 + 3.92E-08*DF - 2.54E-08*UMP + 2.22E-05 *PAD + \epsilon$$

Based on the equation above linear regression results, then :

1. If the independent variable (free) is considered constant then the magnitude of the value of the coefficient (C) in 10 provinces of Sumatra island is 0.376114 is the value of the dependent variable (income inequality) when not influenced by other variables.
2. The value of the regression coefficient variable DF (fiscal decentralization) of 3.92 E-12 indicates a positive relationship with income inequality. That is, every increase in fiscal decentralization by 1%, then income inequality will increase by 3.92 E-12, although the effect is not significant based on the probability value of 0.2126 (>0.05).

3. The value of regression coefficient variable UMP (provincial Minimum wage) of 2.54 E-08 showed a negative relationship to income inequality. This means that every increase in UMP by 1%, then income inequality will decrease by 2.54 E-08. This relationship is significant, because the probability value is 0.0000 ( $<0.05$ ). This shows that an increase in UMP can reduce income inequality.
4. The value of the variable regression coefficient PAD (local revenue) of 2.22 E-05 shows a positive relationship to income inequality, but the effect is not significant because the probability value of 0.8035 ( $>0.05$ ). This means that even if PAD increases, it cannot be ascertained that it has a real effect on income inequality.

### 3.4 Hypothesis Test Results

#### 1. Determination Coefficient Test (R<sup>2</sup>)

Determination coefficient test aims to see how the influence of independent variables on related variables. Here are the results of the R<sup>2</sup> Test:

**Table 10**  
**Test Results R<sup>2</sup> (Random Effect Model)**

<b>R-squared</b>	<b>0.324537</b>	<b>32%</b>
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Source: Output reviews 10 processed 2025

Based on the results of regression panel data presented in the Random Effect Model Method obtained R-Squared value of 0.32453. This value shows that about 32% variation in the dependent variable, namely income inequality (KP) can be explained by three independent variables used in the model, namely fiscal decentralization (DF), provincial Minimum wage (UMP), and local revenue (PAD). The remaining 68% variation in income inequality cannot be explained by all three variables. There are other factors outside the model that can affect the level of income inequality.

#### 2. Statistical T-test results (Partial Test)

Partial Test (t test) aims to determine the significance of individual predictor variables to response variables. T-test can be seen from the magnitude of the probability (p value) compared to 0.05 (significance level ③ =5%). Here are the results of the T-test :

**Table 11**  
**T test results (Random Effect Model)**

Variable	t-count	t-table	Description
DF	1.258580	1,996564	Not Significant
UMP	-5.238019		Significant
PAD	0.249768		Not Significant

Source: Output reviews 10 processed 2025

Based on the output E-Views shown in the table above, it can be done discussion of the results of the t test as follows:

- a. Fiscal decentralization variable obtained t-count value of 1.258580. Where the T-calculated value is smaller than the T-table value of 1.996564, it can be collected that partial fiscal decentralization does not have a significant positive effect on income inequality.
- b. Variable provincial Minimum wage (UMP), obtained t-calculated value of -5.238019 which is greater than the T-table with a value of 1.996564, it can be concluded that the UMP significantly negative effect on income inequality.
- c. Variable Regional original income (PAD) obtained t-count value of 0.249768, which is smaller than the T-table of 1.996564. It can be concluded that PAD does not have a significant positive effect on income inequality.

### 3. F Test Results (Simultaneous Test)

F test is performed to determine whether the two classes have homogeneous variance or not (Ade Novianti, Alwen Bentri, 2021). If the probability is less than 0.05 then  $H_4$  is accepted and it can be concluded that the independent variable simultaneously affects the dependent variable. If the probability is greater than 0.05, then  $H_4$  is rejected and it can be concluded that there is no independent variable that affects the dependent variable. Test the hypothesis simultaneously using the F-test. Here are the results of the F test :

**Table 12**  
**F Test Results (Random Effect Model)**

<b>F-count</b>	<b>F-table</b>	<b>Description</b>
<b>10.57023</b>	<b>2,51</b>	<b>Significant</b>

Source: Output Eviews 10 processed 2025

Based on the results of the test F, obtained F-count value of 10.57023 and F-table of 2.51 at a significance level of 5% . Because the value of  $F\text{-count} > F\text{-table}$  ( $10.57023 > 2.51$ ), it can be concluded that the regression model is significant simultaneously. Which means that together the variables of fiscal decentralization (DF), provincial Minimum wage (UMP), and local revenue (PAD) have a significant influence on the variable of income inequality (KP) of Sumatra island.

Based on the results of the F-test, these findings have clear practical implications. Because regression models show that fiscal decentralization (DF), provincial Minimum wage (UMP), and local revenue (PAD) variables together significantly affect income inequality (KP) on the island of Sumatra, local governments can use this information to design more effective policies. For example, the government may consider reviewing fiscal decentralization allocations, establishing a more equitable provincial minimum wage, or improving local revenue enhancement strategies. By focusing on these



three variables in an integrated manner, they can proactively reduce income inequality and promote more equitable economic growth in the region. The findings underscore the importance of a holistic and integrated policy approach, rather than focusing on just one aspect, to address the complex problem of income inequality.

### **3.5 Discussion**

#### **Fiscal Decentralization On Income Inequality In 10 Provinces On The Island Of Sumatra**

Based on the results of panel regression using Random Effect Model approach shows that the coefficient of fiscal decentralization variable is 3.92 E-12, with t-count value 1.258580 and p-value 0.2126. It is known that t-count 0.05. Thus, it can be concluded that fiscal decentralization does not have a significant positive effect on income inequality in 10 provinces of Sumatra island. Although the results show that the relation of fiscal decentralization variable has a positive direction but the higher the fiscal decentralization variable then income inequality tends to increase, but these results can not be used because the effect is not significant so statistically there is not enough strong enough evidence to state these results.

This is in line with The Theory of Fiscal Federalism by (Oates, 1972). This theory explains how the division of fiscal responsibility between Central and local governments can improve people's efficiency and well-being. Based on The Theory of Fiscal Federalism (Oates, 1972) stating that fiscal transfers such as the General Allocation Fund (DAU) aim to reduce fiscal inequality between regions, empirical analysis is needed to see their relevance in Sumatra. Theoretically, provinces with larger DAUs should have better fiscal capabilities to finance development and public services, which can ultimately reduce inequality, reflected in lower Gini ratios. However, its implementation in the field is not always linear. In fact, some empirical studies show that the magnitude of the DAU does not always correlate positively with a decrease in the GINI ratio. This can happen because DAU allocations tend to be used for routine or operational expenditures, not for capital expenditures or programs that directly impact poverty alleviation and economic equity. Therefore, the effectiveness of DAU in reducing inequality in Sumatra is highly dependent on the priorities and efficiency of local government spending (Oates, 1972).

This result is in line with the research researched by aditya in 2020 entitled "analysis of the effect of fiscal decentralization on income distribution inequality in Indonesia" the results of this study stated that fiscal decentralization had no significant effect on income distribution inequality. (Widyaningsih & Yasin, 2021) In the Sumatran context, differences in fiscal capacity between provinces, limited spending on productive development, and weak regional governance may be reasons why increased fiscal decentralization has not been able to reduce inequality. Fiscal decentralization has not been fully used as an instrument of equity, but rather acts as an administrative tool. Thus, improvements are needed in the design of intergovernmental fiscal transfer systems, institutional strengthening at the regional level,

and monitoring the use of local budgets so that the implementation of decentralization really has an impact on reducing income inequality.

### **Provincial Minimum Wage Against Income Inequality In 10 Provinces On The Island Of Sumatra**

Based on the estimation results with the Random Effect Model model shows that the variable provincial Minimum wage (UMP) has a negative and significant effect on income inequality (KP) in 10 provinces on the island of Sumatra. This is indicated by a coefficient value of  $-2.54 \text{ E-}08$ , with a t-count of  $-5.238019$  and a p-value of  $0.0000$ , which is less than the 5% significance level. Thus, it can be concluded that the increase in UMP is statistically able to reduce income inequality in the study area.

This finding is in line with Keynesian theory, which explains that increasing the income of low-income groups through minimum wage policies will increase purchasing power and reduce inequality (Kharisma & Hanifah, 2020). This theory is supported by the concept of the multiplier effect, whereby an initial increase in consumption will result in an overall greater increase in income and continued consumption, thus promoting economic growth. However, to prove the relevance of this theory in a real context, a more in-depth empirical analysis is needed, for example, by presenting data on the direct relationship between the increase in the provincial minimum wage (UMP) and the decrease in the GINI ratio in different regions. Thus, the discussion is not only limited to theory, but can also be supported by concrete evidence from the field (Keynes, 1936).

These results are in line with previous research conducted by (Kharisma & Hanifah, 2020) with the title “ the effect of economic growth, Minimum wage and unemployment on income inequality in East Java which concluded that the minimum wage has a significant effect on income inequality. Thus, the increase in UMP is one of the instruments of economic policy that plays a role in suppressing income inequality between community groups (Ekonomi & Minimum, 2024).

### **Local Revenue To Income Inequality In 10 Provinces On The Island Of Sumatra**

Based on the estimated regression results using the Random Effect Model (REM), the variable Regional original income (PAD) showed a coefficient of  $2.22 \text{ E-}05$ , t-count of  $0.249768$ , and p-value of  $0.8035$ . Because the value of t-count  $<$  t-table and p-value  $>$   $0.05$ , it can be concluded that PAD does not have a significant positive effect on income inequality (KP) in 10 provinces on the island of Sumatra during the study period.

Although PAD is theoretically the main fiscal resource for local governments to finance development and promote equity, in reality, its effect on inequality is still very limited. This can happen because spending sourced from PAD has not been directed evenly or on target, and is concentrated in sectors that do not directly touch low-income groups. This result is in line with Peacock and Wiseman

(1990) who explained that the development of government spending is not in the form of a straight line but is shaped like a ladder. Implementation of regional development is a program that requires the involvement of the entire community. The role of the government in development is as a facilitator and catalyst certainly requires a variety of facilities and supporting facilities, including the budget in the framework of the implementation of sustainable development (Henrekson, 1990).

The effect of local revenue (PAD) on inequality is still a crucial issue. Theoretically, PAD should ideally be the main source of development financing to reduce inequality. However, empirically, this is not always the case. Provinces with high PAD do not necessarily have low inequality. This phenomenon could be caused by a PAD allocation that is not optimal, where most of the budget is absorbed for routine or bureaucratic spending, not for development programs that directly touch the community, such as improving basic infrastructure, education, or health in remote areas. Thus, although the potential of PAD is great, the benefits have not been fully felt by all levels of society because of uneven and targeted spending priorities.

This result is in line with research conducted by Chintiya Frahita & Siti Fatimah Nurhayati in 2025 entitled "analysis of factors affecting income inequality in the province of Yogyakarta Special Region, 2017-2023" concluded that local original income does not affect income inequality (Aghitsni & Busyra, 2022). Thus, it is necessary to strengthen the fiscal capacity of the region not only in terms of revenue, but also in terms of planning and budget allocation that is able to evenly touch the needs of the community, especially vulnerable groups. Only with good governance can PAD act as an effective inequality reduction instrument.

### **Fiscal Decentralization, Provincial Minimum Wage And Local Revenue Simultaneously Against Income Inequality In 10 Provinces On The Island Of Sumatra In The Perspective Of Islamic Economics**

Based on the estimation of panel data analysis with Random Effect Model (REM) approach, it is obtained that simultaneously, fiscal decentralization (DF), provincial Minimum wage (UMP), and local revenue (PAD) variables have a significant influence on income inequality (KP). This is indicated by the F-count value of 10.57023 which is larger than the F-table of 2.51, as well as the probability value of 0.0000, which is smaller than the 5% significance level. Thus, the regression model states that these three variables together explain the variation in the level of income inequality in 10 provinces on the island of Sumatra.

In terms of conventional economic theory, fiscal decentralization plays a role in providing fiscal independence for regions in order to design and implement development policies that are more in line with local conditions. However, if the implementation is uneven or centered on rich regions only, then

fiscal decentralization can exacerbate inequality between regions. UMP, as a labor income protection policy, has a direct impact on income distribution especially among informal and formal workers. While PAD reflects the extent to which regions are able to explore their own economic potential to fund development, which ultimately also affects economic equity.

In the context of the 10 provinces on the island of Sumatra studied, income inequality is still a major development challenge. Although some provinces such as Riau and South Sumatra have a high PAD, inequality is still seen sharply compared to provinces such as Bengkulu or Jambi. The UMP set by each province is also not necessarily in line with local productivity or cost of living, so that its effectiveness in suppressing inequality is highly dependent on governance and supervision. Likewise, fiscal decentralization is often not accompanied by an increase in regional institutional capacity.

In the Islamic economic perspective, extreme income inequality is contrary to the principles of social justice and economic balance. Islam emphasizes that wealth and resources should not be concentrated in one group only. Well-being is not only determined by economic growth, but by a fair and equitable distribution. Allah SWT says in Surah Al-Baqarah verse 177:

لَيْسَ الْبِرَّ أَنْ تُوَلُّوا وُجُوهَكُمْ قِبَلَ الْمَشْرِقِ وَالْمَغْرِبِ وَلَكِنَّ الْبِرَّ مَنْ آمَنَ بِاللَّهِ وَالْيَوْمِ الْآخِرِ وَالْمَلَائِكَةِ وَالْكِتَابِ وَالنَّبِيِّينَ ۖ وَآتَى الْمَالَ عَلَى حُبِّهِ ذَوِي الْقُرْبَىٰ وَالْيَتَامَىٰ وَالْمَسْكِينِ وَابْنَ السَّبِيلِ ۖ وَالسَّائِلِينَ وَفِي الرِّقَابِ ۖ وَأَقَامَ الصَّلَاةَ وَآتَى الزَّكَاةَ ۖ وَالْمُوفُونَ بِعَهْدِهِمْ إِذَا عَاهَدُوا ۖ وَالصَّابِرِينَ فِي الْبَأْسَاءِ وَالضَّرَاءِ وَحِينَ الْبَأْسِ ۚ أُولَٰئِكَ الَّذِينَ صَدَقُوا ۚ وَأُولَٰئِكَ هُمُ الْمُتَّقُونَ ﴿١٧٧﴾

*"Virtue is not turning your faces toward the East and the West, but it is the virtue of one who believes in Allah, the last day, the Angels, the book, and the prophets; gives to relatives, orphans, the needy, the Wayfarer, the supplicant, and the slave; performs the prayer; gives the poor-rate; keeps his promise when he makes a promise; is patient in adversity, in hardship, and in times of war. They are the truthful, and they are the God-fearing." (Q.S Al-Baqarah : 177)*

This verse shows that the productive and social use of wealth is part of faith, which implicitly rejects structural inequality.

Islam also affirms the importance of justice in property management and public policy. When fiscal decentralization, UMP, and PAD are managed with the principle of justice, then the welfare of the community can be felt more evenly. This is in harmony with the maqāṣid al-sharī'ah, in particular ḥifẓ al-māl (guarding wealth) and ḥifẓ Al-naḥs (guarding life). Fiscal policy in Islam should be in favor of vulnerable groups, and directed to create equitable distribution and sustainable development (Permatasari & Huda, 2022). Furthermore, in Surah Al-Isra ' verses 26-27, Allah SWT warns that people should not use property only for personal pleasure and waste:

وَأَتِذَا الْقُرْىَ حَقَّهَ وَالْمَسْكِينِ وَابْنَ السَّبِيلِ وَلَا تُبَذِّرْ تَبْذِيرًا . إِنَّ الْمُبَذِّرِينَ كَانُوا إِخْوَانَ الشَّيَاطِينِ وَكَانَ الشَّيْطَانُ لِرَبِّهِ كَفُورًا

*"And give to the near relatives their due, and to the needy, and to the Wayfarer, and waste not lavishly. Indeed, the wasteful are the brothers of the Shaitan, and the Shaitan is ungrateful to his Lord." (Q.S Al-Isra : 26-27).*

This verse shows that the utilization of wealth must be accompanied by social responsibility. Therefore, the PAD collected from the people should be used wisely for public spending that can improve the living standards of the poor and lower middle class, not for bureaucratic waste. UMP management also has a dimension of justice in Islam. Establishing a decent wage is part of the 'uqūd al-'adālah (just social contract) between employer and worker. The Prophet (peace be upon him) said::

*"Give the worker his wages before his sweat is dry." (HR. Ibn Majah) The minimum wage must be able to meet the basic needs of workers and their families, not just set formally without realization. Thus, a fair UMP can help minimize economic inequality and ensure the viability of workers ' lives.*

The results of this study support the principles of Islamic economics that emphasize justice, equity, and social responsibility. The simultaneous influence of DF, UMP, and PAD on income inequality shows that fiscal policy and local income should not be viewed separately, but should be managed in an integrated manner to create a fair distribution. If all three are applied by promoting Sharia principles and values of justice, then income inequality between regions can be suppressed, and the welfare of the community will be more evenly distributed as desired by Islam.

#### 4. CONCLUSION

This study examines the effect of fiscal decentralization (DF), provincial Minimum wage (UMP), and local revenue (PAD) on income inequality in the provinces of Sumatra island from 2018 to 2024. The results of the study showed that partially, UMP has a significant negative effect on income inequality, indicating that an increase in UMP can reduce inequality by improving the living standards of low-income people. In contrast, DF and PAD do not have a partially significant effect on income inequality. Nevertheless, simultaneously the three variables, namely DF, UMP, and PAD, significantly affect income inequality. From the perspective of Islamic economics, these findings are in line with the principle of social justice which opposes the unequal distribution of wealth. Therefore, this study concludes that the management of DF, UMP, and PAD fair and transparent is very important to realize equitable welfare in accordance with the values of maqasid al-Shari'ah and Islamic economic principles.

In this study, the main limitation lies in the limited period and scope of the sample, which only analyzed data on the island of Sumatra in the time range 2018-2024. This limitation may affect the generalization of research results to other regions in Indonesia. For further research, it is recommended to expand the sample coverage by adding provinces outside Sumatra island as well as extending the analysis time period. In addition, future researchers may consider other variables that may also affect

income inequality, such as education levels, infrastructure availability, and the dominant economic sectors in each province. More in-depth analytical approaches, such as mixed-methods research that combines quantitative and qualitative data, can also provide a more comprehensive understanding of the complexity of the issue of income inequality in Indonesia.

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