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Macrosocioeconomic Determination of Inclusive Economic Development in Indonesia (Autoregressive Ditributed Lag Panel Model Approach)

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ABSTRACT— High economic growth is essential for inclusive economic development. Economic growth in Indonesia until 2012 has not been inclusive in reducing poverty, reducing inequality, and broadening employment opportunities. Linkages between economic sectors that are increasingly inclusive and a literate society will accelerate the process of inclusive economic development, especially regarding democracy, which clearly has an important role in inclusive economic development besides economic factors. This study uses a panel autoregressive distributed lag (ARDL) model to simulate the relationship between democracy, investment, human capital, trade through, inflation as a picture of the domestic economy, and labor to inclusive economic development. This study uses the KAO cointegration test to analyse the coverage of a data set covering the period from 2011 to 2022 across different provinces within Indonesia. The purpose of this study is to conduct research on a specific topic to obtain results. This study reveals that there is a significant relationship between all independent variables and the dependent variable both in the short and long run, so that it has an impact on sustainability in economic development.

KEYWORDS: macro socioeconomic, inclusive economic development, panel autoregressive distributed lag

1. INTRODUCTION

A concept of economic development known as inclusive economic development ensures that all segments of society-including marginalised groups-benefit from economic progress. It seeks to reduce inequality between groups and geographical regions while improving the well-being of all individuals. One instrument to measure and track a country's level of inclusive growth is the Inclusive Economic Growth Index. This index uses factors such as economic growth, poverty and inequality, and access and opportunity to measure how inclusive development has been. The inclusive economic development index consists of 21 indicators, 3 pillars, and 8 sub-pillars. Economic growth, employment opportunities, economic infrastructure, poverty, inequality and human capacity are its sub-pillars [6].

Advances in information technology and economic development are increasingly closely linked. We are now in the period of society 5.0, when man-made technological advances are taking place. Basically, the idea of civilisation 5.0 is technology-based and human-centric. (PT Garuda Nyala Fajar Indonesia. v3.0.0, 2021) Japan was the first country to establish this idea, which is seen as a development of the fourth industrial revolution and has the potential to reduce the significance of humans. In the period of civilisation 5.0, humans are prioritised in terms of achieving a balance between solving social problems and economic progress.

The fundamental objective of inclusive economic development is to establish a state-managed development

strategy that ensures fairness and equality while upholding and respecting the diversity of society. Any policy formulation process should involve the highest consensus of all parties involved.

An important component of inclusive economic development is stable and sustainable economic growth. A favourable atmosphere for economic growth can be created with the help of appropriate fiscal and monetary policies. In addition, maintaining price stability is also important to foster a favourable atmosphere for economic expansion.

Social factors such as education and health are also important in inclusive economic development. Education can help improve skills and labour productivity, while health can help improve labour productivity and reduce health costs. Gender equality is also important in inclusive economic development as it can help increase labour participation and productivity. In addition to social factors, there are political and legal factors that essentially influence the inclusiveness of economic development.

One important condition for inclusive economic development is high economic growth. Economic activity or the fulfilment of people's daily needs is referred to as economic growth. This is so that income, gender and geographic inequalities can be eliminated through inclusive economic development. Higher quality and more prosperous human resources are the result of this expansion of access and opportunity, and can ultimately lead to greater and more inclusive economic development.

The conditions for inclusive and competitive economic development are carried out by developing a new initiative programme map so that fiscal sustainability is maintained through optimal revenue, efficient and effective state spending, and accountable state financial management to encourage inclusive, quality and sustainable economic growth.

In comparison, an empirical study in Botswana (2014) explained that the allocation of public investment in education was unable to reduce the unemployment rate. The implication is that many people of productive age do not receive decent jobs with inadequate living standards [18]. In India, the economic growth rate of 9% is not proportional to the poverty reduction of 28% [22]. Another study in the Philippines showed that most people did not benefit from rapid economic growth.

The fact that development in Indonesia is still increasing economic growth is often not accompanied by an increase in the welfare of its people. The welfare of the community faces the problem of the quality of economic growth that has not had an impact on the poor, so that until now it has become homework for the Government of Indonesia in finding solutions to the shackles of poverty that colour the Indonesian economy both regionally and nationally.

The main strategies for inclusive economic development are the creation of productive and profitable jobs, the provision of effective and efficient social safety nets to protect those who are unable to work or who benefit too little from development, the improvement of basic public services and adequate public policy support.

Bappenas sets 3 indicators with 8 sub-indicators and 21 categories in an effort to determine the index of inclusive economic development in Indonesia.

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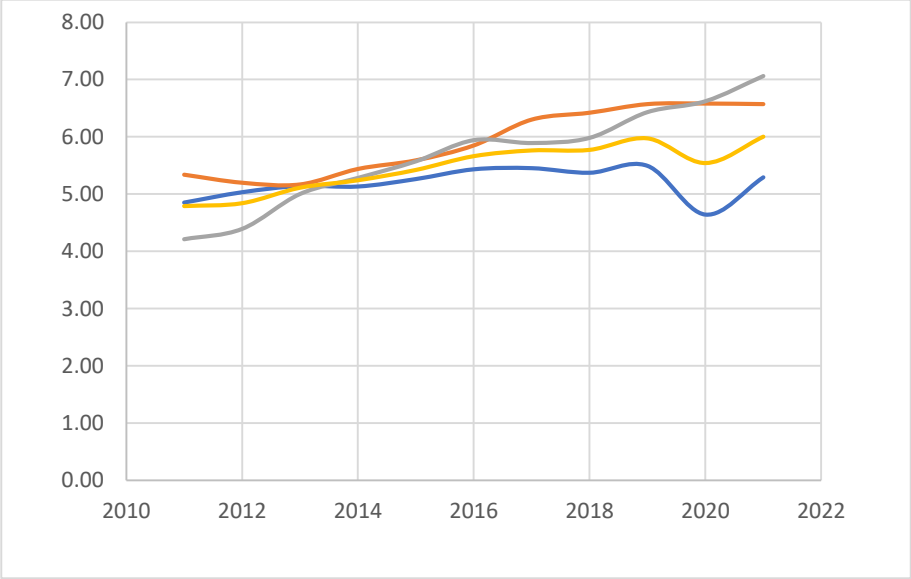

Fig. 1 Indonesia Inclusive Economic Development Index

Blue line is PILAR 1: Growth and Economic Development
Orange line is PILAR 2: Income Equalisation and Poverty Reduction
Gray line PILAR 3: Expansion of Access and Opportunity
Yellow line is Inclusive Economic Development Index

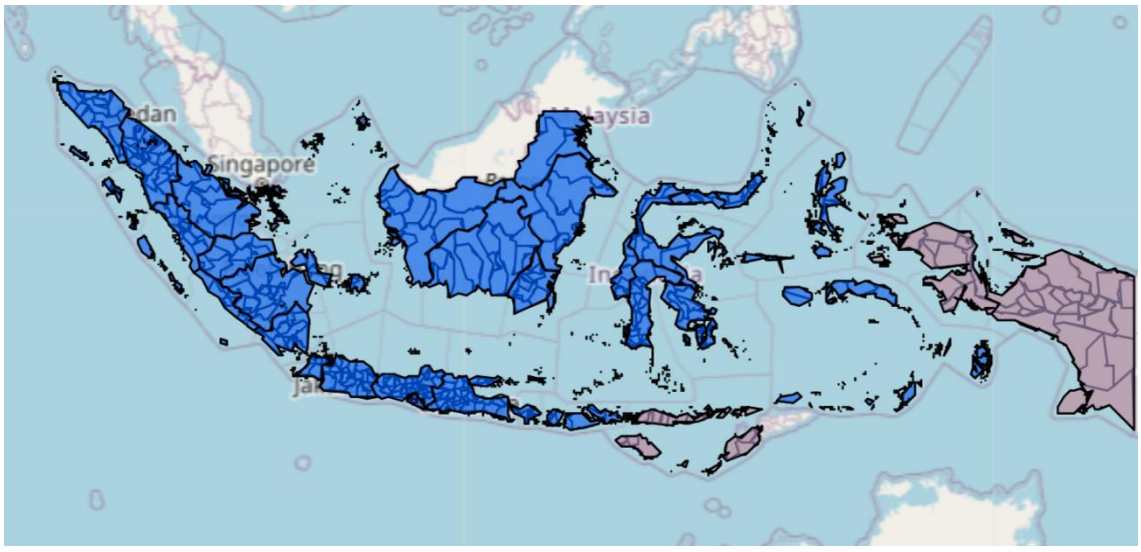

Fig. 2 Indonesia Inclusive Economic Development Index Map

The two figures above show the pattern of Indonesia's inclusive economic development indicators based on three pillars including the first pillar on economic growth and development, the second pillar on income equality and poverty reduction and the third pillar on expanding access and opportunities. From 2011 to 2022 for 34 provinces, the national economic inclusive development index tends to increase with the achievement of an index of 6.00, meaning that national economic development is inclusive with a reduction in poverty levels, but the unemployment rate fluctuates relatively downward and in contrast to the income inequality index which is relatively stable in the period 2011 to 2022.

The strategic role in growing the economy of a country or region cannot be separated from economic factors

that can be controlled through economic policies on both a micro and macro scale. Macroeconomic policies are believed to be able to influence inclusive growth. Starting from fiscal policy and monetary policy, such as how the correlation between inflation and the economy, the proportion of investment, the money supply, economic interest rates, state spending, export and import activities and others, even the global economic situation also has an impact on the domestic economy inclusively.

This study certainly describes the situation and conditions specifically how the determination of macro socio-economic variables on inclusive economic development in the short term and long term in Indonesia, so that the hope to be achieved can be fulfilled by analysing the determination of macro socio-economic variables on inclusive economic development that has been put forward.

2. Theoretical Review

Macroeconomic Aspects

[6] The Inclusive Economic Development Index is a tool to measure and monitor the level of inclusiveness of Indonesia's development at the national, provincial and district/city levels. The Inclusive Economic Development Index measures the inclusiveness of development in Indonesia through aspects of economic growth, inequality and poverty, and access and opportunity. The index figure consists of 3 pillars and 8 sub-pillars as well as 21 indicators forming the inclusive economic development index.

Inclusive development must ensure economic equality to all levels of society, inequality in terms of income, gender, and region must be eliminated. Poverty alleviation is a sufficient condition for inclusive economic development. In addition, economic growth accompanied by high poverty rates makes the growth itself unsustainable.

Poverty reduction is a common goal of inclusive economic development and pro-poor growth. In terms of income equality, inclusive growth is multifaceted [25]. While inclusive economic development emphasises equality across all socioeconomic levels-poor, middle class and rich-pro-poor tends to focus more on those living below the poverty line. This is because economic progress that only benefits the poor is in danger. Declining economic growth and to improve new economic prospects, a sustainable economic development paradigm that prioritises equity across social strata is needed [19].

One strategy that has emerged in growth theory is inclusive economic development [2]. This is in line with how UNDP defines inclusive economic growth, which it defines as growth that increases community involvement so that everyone can benefit from the growth. According to [2], inclusive economic growth is growth that can reduce the gap between the agricultural and non-agricultural sectors. Consequently, it can be claimed that inclusive economic growth is not only the pursuit of rapid growth but also equity as indicated by a decrease in income disparity.

The main concerns of macroeconomics are threefold: inflation, output growth, and unemployment. A government policy maker would want low inflation, high output growth, and low unemployment. But in macroeconomics, not everything works. If we improve one side, we will worsen the other side. Thus, macroeconomics is full of trade-offs.

[5] starts with the view that inflation in a sense implies that prices are actually rising. This raises two questions; firstly what do we mean by rising prices and secondly if prices are agreed to rise are all such rises to be considered as symptoms of an inflationary situation? Whatever set of definitions are adopted and therefore

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the answers to these questions are bound to involve different arbitrary elements. Since a common price level measure is chosen, it is necessary to define an inflationary situation in those terms.

[4] in the simplest economic model, there are only two factors of production: capital and labour. The capital stock includes all fixed assets associated with productive capacity (e.g., plant, machinery, plant and equipment, inventories) and/or future consumption, e.g., residential fixed assets. The main defining characteristic of these fixed assets is that they represent postponed consumption: people invest in fixed assets because they expect these assets to produce goods and services in the future.

[3] in a paper present data and analyse the structure of employment in thirteen African economies at the administrative unit level, focusing on service roles. We provide two new pieces of evidence. First, we present a descriptive picture of the changing composition of employment over time and across geographies. This reveals evidence of structural transformation towards service and service-related employment at the sub-national level and provides a comprehensive picture of who works in services and where and how this has changed over time. Second, we provide a correlation between services and economic development, using per capita nightlight luminosity as a proxy. We document (a) a strong positive relationship between high-skilled services and economic development; (b) substantial heterogeneity across industries in services; and (c) the mediating role of market conditions and technology in the relationship between services and economic development. Overall, our work highlights the important role of service activities for employment, skills, and economic development in Africa.

[24] explain labour markets are given a key role in the recent literature on economic growth. This may not be apparent at first, as many models do not refer explicitly to the structure of labour markets. But on deeper inspection of the most popular recent models, it is always found to be the case. Various "engines of growth" are commonly discussed in the growth literature, which are directly or indirectly related to human capital and the adoption of new ideas. The growth engine in Solow's basic model is unspecified labour-enhancing technology; what would labour-enhancing technology be if it were not linked to human capital? In other models it is the ability to introduce new products, i.e. the knowledge of how to do new things. And in others it is explicitly "human capital" without discussing specifically what human capital does to output growth and how. The conclusion reached from reading the recent growth literature is that if we want to understand growth and development, we need to understand the creation and deployment of human capital.

Open economics for developing countries focuses on fiscal, monetary and exchange rate issues that are important for less developed economies. [11] argue that the dichotomy between short-term macroeconomic stabilisation objectives and long-term economic growth objectives commonly found in developing country policy frameworks is inappropriate. The authors report empirical evidence to support the proposition that macroeconomic stability is a prerequisite for sustainable economic growth and the root of macroeconomic instability in developing countries lies in government budget deficits.

The article by [28] revisits previous studies related to the relationship between export instability, export diversification, and economic growth. In this regard, an extensive literature survey has been conducted across academic journals that provide structured, comprehensive, and chronological findings and results. The authors have examined and reviewed the full text of eighty-eight important and relevant research articles published in various scholarly journals. Most of the articles provide strong evidence on the positive impact of export diversification on economic growth and mixed results on the impact of export instability on economic growth. The paper also attempts to find areas where the existing literature is silent or highlights that need to be further examined with future research in this area. Since the literature provides little evidence on various aspects of

export diversification and economic growth from the perspective of the group of emerging economies identified by UNCTAD and IMF, this article recommends future research in this context to explore this unexplored area.

Socio-political Aspects

[26] suggest in their study that scholars have investigated the impact of economic openness and democracy on income inequality in two separate literatures. In the study of democracy, scholars agree that democracy reduces income inequality, but the empirical evidence is mixed. In the literature on globalisation, the effect of economic openness on income inequality is debated, but has not been studied in depth. To the best of our knowledge, our analysis is the first systematic statistical study of the effects of economic openness and democracy on income inequality. We argue that both effects need to be studied together. In other words, the exclusion of one variable or the other may lead to incorrect conclusions about the determinants of income inequality.

Our empirical analysis covers 69 countries over the period 1960 to 1996. We focus on the impact of trade, FDI, foreign financial capital inflows, and democracy on income inequality. We find that higher levels of democracy reduce the level of income inequality within countries. Trade openness is associated with a more equal distribution of income within countries, FDI is associated with greater income inequality, and foreign financial capital inflows have no statistically significant effect on income inequality. All findings are robust across different measures of income inequality, and alternative statistical estimators and model specifications.

3. Methodology

Data and Variables

This research approach is a quantitative approach by focusing on a single country, namely the territory of Indonesia in 34 provinces in the analysis timeframe, namely 2011 - 2022. This approach was chosen with the aim of being able to recommend appropriate and specific economic policies in an effort to realise inclusive economic development in Indonesia.

This research uses ARDL (Autoregressive Distributed Lag) with panel data. The application of the ARDL panel model in this situation is something new in solving similar research problems.

Tabel 1 Variables and Definitions

Variables	Definitions
PEI	the national inclusive economic development index in a given year, with index units in 34 provinces within Indonesia
INF	inflation is the index of consumer price increases in a particular year in 34 provinces in the territory of Indonesia with units of percentage
INV	national investment or gross fixed capital formation of 34 provinces in Indonesia in rupiah units
EX	EX is export which is the export value of 34 provinces in the territory of Indonesia with units of rupiah
HDI	Human development index as a measure of the quality of human capital in a particular year in 34 provinces in the territory of Indonesia with index units
Dem	a quantitative measure of the situation and condition of democracy in 34 provinces in Indonesia with index units

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The model constructed is Panel ARDL for cointegrated time series

$$PEI_{it} = \beta_0 + \beta_1 INF_{it} + \beta_2 LINV_{it} + \beta_3 LEX_{it} + \beta_4 HDI_{it} + \beta_5 Dem_{it} + e_{it} \ldots\ldots \quad (1)$$

Based on equation (1), the panel data ARDL equation model can be described, namely:

$$\Delta PEI_{it} = \alpha_0 + \sum_{i=1}^{n} \alpha_{1i} \Delta INF_{it-p} + \sum_{i=0}^{n} \alpha_{2i} \Delta LINV_{it-p} + \sum_{i=0}^{n} \alpha_{3i} \Delta LEX_{it-p} + \sum_{i=0}^{n} \alpha_{4i} \Delta HDI_{it-p} + \sum_{i=0}^{n} \alpha_{5i} \Delta Dem_{it-p} + \beta_1 INF_{it-p} + \beta_2 LINV_{it-p} + \beta_3 LEX_{it-p} + \beta_4 HDI_{it-p} + \beta_5 Dem_{it-p} + e_{it-p} \ldots\ldots \quad (2)$$

where Δ denotes the first difference. The coefficients (β_1-β_5) indicate the long-term relationship while the coefficients (α_1-α_5) represent the short-term dynamics of the model. Based on equation (2), the error correction of the ARDL model can be arranged as follows:

$$PEI_{it} = \alpha_0 + \sum_{i=1}^{n} \alpha_{1i} \Delta INF_{it-p} + \sum_{i=0}^{n} \alpha_{2i} \Delta LINV_{it-p} + \sum_{i=0}^{n} \alpha_{3i} \Delta LEX_{it-p} + \sum_{i=0}^{n} \alpha_{4i} \Delta HDI_{it-p} + \sum_{i=0}^{n} \alpha_{5i} \Delta Dem_{it-p} + \gamma ECT_{it-p} + e_{it} \ldots\ldots \quad (3)$$

where ϒ is the speed adjustment parameter and ECT is the residual obtained from estimating the cointegration model of equation (2).

4. Results and Discussion

Not all variables are in the root level test so that the test results show that the data is stationary in the first difference. This is indicated by looking at the probability value at the time of testing. Data is considered stationary if the probability value is <5%. Furthermore, this test is carried out to determine the optimal lag position, namely at lag 2. After determining the lag to ensure a stable estimation model, it can be seen that the model is stable and passes the stability test. Time series data can only be said to be stationary if the data does not contain unit roots, in other words that the mean, variance, and covariance are constant over time.

Table 1 Unit Root test Results of Series

	ADF (Prob.)		**PP (Prob.)**	
	Without Trend (0)	Without Trend (1)	Without Trend (0)	Without Trend (1)
PEI	0.43	0.00	0.77	0.00
DEM	0.08	0.00	0.05	0.00
EX	0.00	0.00	0.00	0.00
INV	0.00	0.00	0.00	0.00
HDI	0.73	0.00	0.00	0.00
INF	0.01	0.00	0.17	0.00

The cointegration test results show that of all variables there is a long-term reciprocal relationship or cointegration with the KAO residual test, so the model shows that the upper part of Table 2 is a long-term relationship between all the variables studied. While at the bottom of the table is the interpretation of the short-term relationship of all the variables in question.

Table 2 Cointegration KAO

	t-Statistic	Prob.
ADF	-12.34006	0.0000
Residual variance	0.008976	
HAC variance	0.016321	

Cointegration testing through the KAO Test shows that all variables studied in the period 2011 to 2022 have a long-term relationship or are cointegrated. Thus, ARDL analysis with panel is applied in this study.

In the long run, it can be seen that INF, INV, EX, HDI and DEM affect inclusive economic development (PEI), each with an estimated value of -0.001347, -0.020390, 0.222799, and 0.012302. In the long run, it illustrates the positive influence of HDI and DEM. In the short term INF, INV, and EX have an effect on inclusive economic development (PEI), only HDI and INF have a negative effect on PEI. At the bottom of Table 4.3, the short-term relationship of all variables can be seen in the short term; with estimates of DEM (0.0034), EX (0.0944), INV (0.0245), HDI (0.5471), and INF (0.0745).

Table 3 ARDL Panel Results

Variable	**Co-efficient**	**Std.Error**	**t-stat**	**Prob.**
Long-term Results				
INF	-0.001347	0.002784	-0.483754	0.6286
LOG(INV)	-0.020390	0.005418	-3.763117	0.0002
LOG(EX)	-0.118567	0.012821	-9.247696	0.0000
HDI	0.222799	0.004003	55.66303	0.0000
DEM	0.012302	0.001407	8.745074	0.0000
INF	-0.001347	0.002784	-0.483754	0.0000
Short-term Results				
COINTEQ	-0.302247	0.031336	-9.645318	0.0000
D(PEI(-1))	0.781804	0.040974	19.08060	0.0000
D(INF(-2))	0.004395	0.025407	0.172994	0.8627
DLOG(INV)	0.012931	0.017507	0.738592	0.4603
DLOG(INV(-2))	0.011123	0.012283	0.905584	0.3653
DLOG(EX(-2))	0.196358	0.146982	1.335928	0.1818
D(HDI(-2))	0.732329	0.205458	3.564374	0.0004
D(DEM(-2))	0.002318	0.012483	-0.185722	0.8527
C	-3.018861	0.317427	-9.510416	0.0000

The cointegration test results in Table 3 show that the value of CointEq = -0.302247 is significant at the 5% level, which means that there is long-term cointegration in this model. The CointEq coefficient will then be used to measure the speed of adjustment, which is the speed of adjustment in response to changes. The ECT or CointEq value is valid if the coefficient is negative with a significant probability at the 5% level. In this study, the ARDL (1,3,4,4) model has fulfilled these validity requirements, so it can be concluded that the model will lead to equilibrium at a speed of 30.22% per year.

The results of the Granger causality test analysis can be seen in Table 4 which shows that the causality relationship occurs between the variables studied, with a probability value smaller than 0.05. While the causality relationship between other variables is partly significant and partly insignificant.

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Table 4 Pair wise granger casuality

Variable	PEI	INF	INV	EX	HDI	DEM
PEI	1	1.693	3.842 **	12.978 ***	49.814 ***	1.982
INF	19.294 ***	1	4.879 ***	1.795	16.909 ***	25.773 ***
INV	2.546 *	4.837 ***	1	8.353 ***	1.965	0.200
EX	9.488 ***	3.613 ***	35.605 ***	1	1.108	1.956
HDI	48.096 ***	2.353	2.897	4.335 **	1	0.573
DEM	19.099 ***	20.433 ***	0.994	1.345	27.433 ***	1

5. Conclusions and Implications

Indonesia is actively pursuing comprehensive and sustainable economic change with a focus on inclusiveness. This change is centred around four key pillars: poverty reduction and elimination of severe affluence, improving the quality of education and healthcare, revitalising industry and promoting applied research, and strengthening enterprise competitiveness.

The Inclusive Economic Development Index serves as a comprehensive metric to assess and track the inclusiveness of Indonesia's development across multiple scales, including the national, provincial, and district/city levels. It evaluates the level of development inclusion in Indonesia by considering various dimensions such as economic growth, inequality, poverty, and access and availability of opportunities. The index points show a consistent upward trend, increasing from 4.79 in 2011 to 6.00 in 2021.

Inclusive economic development requires high economic growth rates. The economic growth observed in Indonesia until 2012 did not demonstrate inclusion in terms of poverty reduction, inequality reduction, and employment. Increased interconnectedness within the financial sector and improved financial skills are expected to accelerate progress towards equitable economic growth.

Increased human capital with higher qualifications and prosperity has the potential to contribute significantly to high levels of economic development that are broad-based and inclusive. Therefore, it is critical to ensure that the development of access and possibilities is done with human capabilities in mind. The presence of economic infrastructure is essential to facilitate the achievement of growth objectives. Infrastructure serves as an important means of support, facilitating the extension of access for individuals to utilise the benefits of strong economic growth.

In recent years, there has been a significant escalation in geopolitical risks on a global scale, impacting economic inclusiveness. However, it is important to note that there is growing inequality emerging with respect to the use of available economic resources, the promotion of trade liberalisation, and the achievement of environmental and social sustainability as well as democratic situations. This study utilises an autoregressive disturbed lag (ARDL) panel model to simulate the relationship between democracy, investment, human capital, trade through exports, inflation as a domestic economic picture to inclusive economic development.

This study uses Granger causal tests. The analysis covers a dataset covering the period from 2011 to 2022

across different provinces within Indonesia. The purpose of this study is to conduct research on a particular topic to obtain results. This research reveals that there is a significant relationship between all independent variables to the dependent variable in both the short and long run thus having an impact on sustainability in economic development. This analysis provides validation for the feedback effect seen between all variables. Granger causal tests, nonlinear regression error models, and threshold regression models are all statistical methods used in econometric analysis to assess the causal relationship between variables.

The government has the ability to proactively predict and plan for the sustainability of economic inclusiveness in future economic development. The democratic factor is closely related to the openness of public access to economic conditions both in regulation and policy. Allocating resources in diplomatic initiatives aims to enhance regional dynamics and promote stronger relations with neighbouring countries in the region.

Changes that occur in one variable will affect other variables. Indonesia can always provide an intensive increase in investment, infrastructure development, human quality development both education and health, export-oriented trade promotion and industrialisation of business fields are an important part of opening up employment opportunities. Maintaining and improving access and political participation for the community turns out to have a positive correlation in the necessary economic policies. Similar research in the future is expected to increase the observation period with a longer time period and add competent social and economic variables.

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