

INCLUSIVE ECONOMIC DEVELOPMENT IN INDONESIA: AN EMPIRICAL STUDY OF LOCAL GOVERNMENT CONTRIBUTION

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ABSTRACT

This research attempts to present empirical evidence of the determinants of inclusive economic development in Indonesia, specifically from local government contributions. We used secondary data from the related government institutions in Indonesia in 2019, analyzed with multiple regression. Our analysis figures out that the local governments have reached a satisfactory level of inclusive economic development, although the West Indonesian region still delivers better achievements than the East Indonesian region. Moreover, the empirical analysis demonstrates an insignificant effect on local government economic function development and local wealth, which indicates the need for improvement. Meanwhile, the supervision conducted by the local government exhibits a positive effect on inclusive economic development, which emphasizes the importance of the government's role in safeguarding public interest in the pursuit of local development improvement. The study provides several practical implications for local governments to increase their role in supporting inclusive economic development. First, the quality of spending in local government must be improved from planning to realization. Local governments should also optimize local wealth with optimal asset utilization to realize its potential benefits. Finally, adequate supervision must be maintained in both procedural and financial aspects in every program implementation so that inclusive economic development can occur all over Indonesia.

Keywords: *Indonesia, local government, inclusive economic development, economic function spending, local wealth, supervision*

Penelitian ini berupaya memperoleh bukti empiris terkait determinan pembangunan ekonomi inklusif di Indonesia, khususnya dari kontribusi pemerintah daerah. Peneliti menggunakan data sekunder dari instansi pemerintah terkait di Indonesia pada tahun 2019 yang dianalisis dengan regresi linier berganda. Analisis kami menunjukkan bahwa pemerintah daerah telah mencapai tingkat pembangunan ekonomi inklusif yang cukup memuaskan meskipun wilayah Indonesia Barat masih memiliki pencapaian yang lebih baik daripada wilayah Indonesia Timur. Selain itu, analisis empiris menunjukkan pengaruh yang tidak signifikan dari belanja fungsi ekonomi pemerintah daerah dan kekayaan daerah yang mengindikasikan perlunya perbaikan. Sementara itu, pengawasan yang dilakukan oleh pemerintah daerah berdampak positif terhadap pembangunan ekonomi inklusif yang menekankan pentingnya peran pemerintah dalam menjaga kepentingan masyarakat dalam upaya peningkatan pembangunan daerah. Studi ini memberikan beberapa implikasi praktis bagi pemerintah daerah untuk meningkatkan peran mereka dalam mendukung pembangunan ekonomi inklusif. Pertama, kualitas belanja pemerintah daerah harus ditingkatkan dari perencanaan hingga realisasinya. Pemerintah daerah juga perlu mengoptimalkan kekayaan daerah dengan pemanfaatan aset secara optimal untuk merealisasikan potensi manfaat aset. Terakhir, pengawasan yang memadai harus dilakukan baik secara prosedural maupun finansial dalam setiap pelaksanaan program agar pembangunan ekonomi inklusif di seluruh Indonesia.

Kata kunci: *Indonesia, pemerintah daerah, pembangunan ekonomi inklusif, belanja fungsi ekonomi, kekayaan daerah, pengawasan*

INTRODUCTION

Economic development has been one of the main focuses for many countries in a global context (Schumpeter, 2020). It is one of the most important aspects of development to secure a country's position

as a developed country (Todaro & Smith, 2020). Economic development is crucial to ensuring the level of national welfare, so economic development needs to be inclusive to make certain that it can be enjoyed by all of the people within the

nation in all areas and all groups (Pukuh & Widyasthika, 2017). Therefore, inclusive economic development is pursued by a lot of countries, especially the developing ones such as Indonesia. Indeed, the country is currently also in pursuit of inclusive development (Kusdarjito, 2017), especially considering that Indonesia has abundant resources that have not been maximized for public welfare (Sandjaja, Nafisa & Manurung, 2020). In line with that, the National Development Planning Agency (BAPPENAS), as one of the ministries responsible for taking care of economic development, issued the Inclusive Economic Development Index. It is important to ensure that the direction of economic development is moving towards inclusiveness and sustainability (Rahma, Fauzi, Juanda & Widjojanto, 2019).

Indonesia is a developing country in Southeast Asia that has suffered from significant economic development issues for the past decade (Siburian, 2020). The issues arise in the form of economic disparity, income inequality, unemployment, and severe poverty (Novak, 2017). According to the data from BAPPENAS, the achievement of inclusive economic development in the East Indonesia region is still below average (National Development Planning Agency, 2020). The Central Statistics Bureau (BPS) also states that there are 25.14 million Indonesians who live in poverty, with the East Indonesian region having a significantly higher poverty rate (Central Statistics Bureau, 2019). In an attempt to deal with the existing economic development issues and jump to being a developed country, the Indonesian government has made a great commitment to inclusive economic development (Warburton, 2018). The initial commitment surely started with the decentralization policy that increased the role of local governments in realizing local development (Aritenang, 2020; Siburian, 2020; Vujanovic, 2017). The government's commitment is further translated into various government programs and policies, such as poverty alleviation (Dewi, Abd Majid, Aliasuddin & Kassim 2018),

community empowerment (Badaruddin, Kariono, Ermansyah & Sudarwati, 2021), and infrastructure development (Sebayang & Sebayang, 2020).

Indeed, previous studies suggest that the role of the government is crucial for realizing good economic development (Yuliadi, 2020). Therefore, the existence of studies that explore the issues regarding the role of the Indonesian government in realizing inclusive economic development is necessary and becomes an interesting thing to do. Indonesia is a country that implements decentralization policies that grant great authority to local governments to run government functions that are essential to supporting development at the local level (Lewis, Nguyen & Hendrawan, 2020; Talitha, Firman & Hudalah, 2020). Each local government is given authority to manage their own financial resources, specifically the local budget and wealth (Sutaryo, Sahari, Jakpar & Balia, 2022b). Under the assumption that the local government knows better its own potential, decentralization is expected to accelerate local development (Setiawan, Tjiptoherijanto, Mahi & Khoirunurrofik, 2022).

However, there are considerably limited empirical studies that investigate the role of local government in supporting inclusive economic development in Indonesia, especially at the local level, considering the fact that Indonesia is a decentralized country. The study fills the limitation gap and contributes to the literature as one of the earliest studies to empirically examine the role of local government in inclusive economic development in Indonesia. Firstly, the study focuses on economic function expenditure, which has been less explored in previous studies. Secondly, the local wealth factor is also investigated to see how well the local government has maximized its potential. Lastly, the supervision factor is also examined to figure out whether the local government has conducted the supervision of the development agenda properly. Thus, the study is expected to be beneficial in evaluating to what extent local government

has contributed to the pursuit of inclusive economic development based on empirical examination. This research also provides a comprehensive analysis to enrich the Indonesian public sector literature. The rest of the paper is arranged in the following order: literature review, research method, results and discussion, and conclusion.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency Theory

The theoretical foundation of this research is based on an understanding of agency theory. Widely adopted in many social science studies, the agency theory that was developed by Jensen & Meckling (1976) explains the agency relationship between the principal and agent that delegates the authority to the agent to act to fulfill the principal's interests. The relationship that is potentially subject to agency problems (Mäntysaari, 2010). The theory is also relevant for government context (Hay & Cordery, 2018; Maggetti & Papadopoulos, 2016), including in Indonesian local government, in which the local government acts as the agent while the public acts as the principal who delegates the authority to the government to manage local resources for local development to maximize public welfare (Adiputra, Utama & Rossieta, 2018; Sutaryo, Sahari, Jakpar & Balia, 2022a). In addition to being the goal of the delegation of authority to manage financial resources, the improvement of public welfare often becomes a political promise of the executive to the public during the election. Therefore, the public has the right to demand increased public welfare through inclusive economic development programs.

From the perspective of agency theory, the first factor that should be put into consideration in regards to inclusive economic development is local financial resources that the public has delegated management to local government. Local financial resources manifest themselves in the form of government spending budgets and local wealth that the government needs to manage as an agent to implement

government policies and programs (Saragih, 2022). Therefore, local government spending and local wealth are important to study to reveal whether they have contributed significantly to the development or not. However, due to the agency problem, the government as the agent may behave against the interests of the public, such as through corruption (D'Agostino, Dunne & Pieroni, 2012). As a consequence, a supervision mechanism is implemented, one of which is internal control, which adopts the COSO concept to ensure that government institutions can be held accountable by achieving the goals, ensuring asset safety, complying with regulations, and producing reliable financial statements (COSO, 2013). Hence, supervision is also an important factor to examine.

Local Economic Function Spending and Inclusive Economic Development

Local government expenditure has been widely regarded as a potential factor in improving local development (Yuliadi, 2020). For example, Wiryawan & Otchia (2022) reveal the essential role of LG spending on local industrial development that will improve the economy. The local government has specific programs and policies to improve economic development. In practice, government spending is classified into several functions, one of which is the specific spending in the economic function to fund programs related to economic development within the local government (Sandria & Dinarjito, 2020). Previous studies have demonstrated that government spending is a significant factor that contributes to local development (Saragih, 2022), more specifically economic development (Yuliadi, 2020). Moreover, specific allocations for economic functions will support the funding of government programs for economic development. The higher the allocation, the more likely it is to cover the programs that are important to accelerate the output and outcomes of local economic activities, such as supporting SMEs (Prasetyo, 2020; Rachmania, Rakhmaniar & Setyaningsih, 2012), community

empowerment (Badaruddin et al., 2021), employment (Islam & Islam, 2021), increasing finance access (Rumbogo, McCann, Hermes & Venhorst, 2021), increasing capital investment (Yuliadi, 2020), optimizing local potential, etc. With the above arguments, the following hypothesis is stated:

H1: Local economic function spending positively affects inclusive economic development

Local Wealth and Inclusive Economic Development

Local wealth, represented by financial resources (Dalimunthe, Fadli & Muda, 2015), also becomes a considerable factor that may contribute to local development, specifically in improving economic development. With the support of local government, the development agenda at the local level can be successful (Rokhim, Wahyuni, Wulandari & Ayu, 2017). Saragih (2022) mentions that local governments with greater local wealth have a greater potential to realize better local development, especially when supported by good resource management (Bukit, 2020). Larger local wealth will enable the local government to open opportunities for businesses to grow within the area. When local government is able to unlock the available economic potential, it will increase the level of economic activity in the local government (McInroy, 2018). It has a great implication for economic development as the circumstances will create the potential for local people's employment and trigger the local SMEs to grow, which ultimately will help tackle existing issues such as unemployment and poverty. On the other hand, when the business grows within the area, local government can also help increase local government revenue, which will be helpful in funding more government programs and contributing more to local development. Therefore, developing local potential appropriately is expected to stimulate economic growth and development (Hartati, Yunani & Nur, 2018). Based on the explanation above, the following hypothesis is formulated:

H2: Local wealth positively affects inclusive economic development

Local Government Supervision and Inclusive Economic Development

The supervision will ensure that the implementation of government financial management is accountable (Muhtar, Payamta, Sutaryo & Amidjaya, 2020; Sutaryo & Sinaga, 2018). The government internal control system in Indonesia is developed by adopting the COSO concept, which aims to ensure that local governments can fulfill their accountability to the public (Utami & Widarjo, 2022). Firstly, the supervision of the internal control system is aimed at achieving the desired goals effectively and efficiently (Sutaryo et al., 2022a; Winarna, Muhtar, Sutaryo & Amidjaya, 2021). In the context of inclusive economic development, it will help ensure that local government is able to achieve the desired development output and outcomes continuously. Secondly, adequate supervision through internal control will ensure asset safety and minimize the risk of fraud (Maulidi & Ansell, 2022; Rendon & Rendon, 2016). It will help ensure that the financial resources are free from the corrupt behavior of irresponsible parties (Hasnawati & Amin, 2020) so that the resources are utilized in accordance with the specified programs. Also, the implementation of a government internal control system will ensure that the activities of local government comply with the regulation (Graham, 2015) so that the desired goals can be achieved accordingly, including inclusive economic development. Based on the above explanation, the hypothesis is formulated as follows:

H3: Local government supervision positively affects inclusive economic development

RESEARCH METHODS

Population, Samples, and Research Data

The design of the study is an empirical causality study with a quantitative approach to investigate the determinants of inclusive local government economic development. The population of the study is all local governments in Indonesia, with

a total of 514 local governments during the 2019 fiscal year. The sample selection process is conducted using the purposive sampling technique. We exclude local governments with administrative region status and those with unavailable information that the study needs, which finally generates 452 observations. Our research data is secondary data obtained from authorized government institutions, namely the BAPPENAS, Ministry of Finance, Financial and Development Supervisory Agency, and Central Statistics Bureau.

Research Variables

The dependent variable that becomes the main focus of the study is inclusive economic development, which is represented by the inclusive economic development index published by BAPPENAS. The independent variables consist of a) local government economic function spending measured by using the natural logarithm of economic function spending per capita; b) local wealth measured with the natural logarithm of local government assets; and c) local government supervision proxied with the maturity score of the local government

internal control system. The study also uses several control variables that consist of the level of unemployment, poverty, and local human development quality, as well as the geography and type of local government. The details of the research variables and the operational definition are presented in Table 1.

Data Analysis

The analysis of our research data uses a quantitative approach. Our analysis begins with descriptive statistics to generate general summaries of our research phenomena, followed by correlation analysis. The main analysis is hypothesis testing, which is performed with multiple regression. Multiple regression analysis will examine the effect of local government economic function spending, local wealth, and local government supervision as the determinants of inclusive economic development. The regression model is formulated as follows:

$$IEDI = a + \beta_1 ECO_EXP + \beta_2 WEALTH + \beta_3 SPV + \beta_4 UNEMP + \beta_5 POV + \beta_6 HDI + \beta_7 GEO + \beta_8 TYPE + e \quad (1)$$

Information: IEDI : Inclusive economic development; a : Constant; β : Regression

Table 1.
Operational Definition of Research Variables

Variable	Notation	Measurement	Sources
Inclusive economic development	IEDI	Local government inclusive economic development index	BAPPENAS
Economic function spending	ECO_EXP	Natural logarithm of local government economic function spending per capita	Ministry of Finance
Local wealth	WEALTH	Natural logarithm of local government asset	Supreme Audit Board
Local government supervision	SPV	Local government internal control maturity score	Financial and Development Supervisory Agency
Unemployment	UNEMP	Total unemployment divided by total population	Knoema Database
Poverty	POV	Total people living under poverty level divided by total population	Knoema Database
Human development quality	HDI	Local human development index (HDI)	Central Statistics Bureau
Local government geography	GEO	Dummy method: 1: Local government in Java 0: Local government outside Java	Ministry of Internal Affairs
Local government type	TYPE	Dummy method: 1: City local government 0: District local government	Ministry of Internal Affairs

coefficient; ECO_EXP: Economic function spending; WEALTH: Local wealth; SPV: Local government supervision; UNEMP: Unemployment; POV: Poverty; HDI: Human development quality; GEO: Local government geography; TYPE: Local government type; e: error.

ANALYSIS AND DISCUSSION

Descriptive Statistics

The analysis of our research data begins with descriptive statistics analysis, which is useful to obtain a general summary of research phenomena. We discover that the overall achievement of inclusive economic development by Indonesian local governments has reached a satisfactory level with an average score of 5.447. Nevertheless, the achievement is still within the middle area of the satisfactory score range, and therefore there is still a significant gap to catch to reach a very satisfactory level. The highest achievement score is 6.85, which is still within satisfactory levels but has not reached a very satisfactory level yet. The lowest score is 3.1, meaning that is still below a satisfactory level. The result of descriptive statistics is presented in Table 2.

As for the independent variables, local government economic function spending shows average value of 13.035 with actual value of 106 billion rupiahs per capita. The highest reaches around 458 thousand rupiahs per capita, while the lowest is around 98 thousand rupiahs per

capita. Local wealth has a mean value of 28.56, indicating that the average local wealth is around 3.2 trillion rupiahs. Meanwhile, local government internal supervision has an average value of 2.779, indicating that the overall internal control maturity is still at level 2 or within the developing stage. The highest score has reached 3.904, which is at level 3, or within a defined stage, and has almost reached level 4, or managed and measured stage. In addition, a spatial analysis is further performed to examine the distribution of local government-inclusive economic development in each region. We discover that Java, Sumatra, Borneo, and Sulawesi have better inclusive economic development as compared to the East Indonesian region, confirming previous studies that evidence the disparity in Eastern Indonesia (Pukuh & Widyasthika, 2017). The result of the spatial analysis is depicted in Graphic 1.

In addition to the descriptive statistics, we also run a correlation analysis to check whether there is any multicollinearity among the independent variables. It is evidenced that there is no collinearity issue, so the regression analysis can be performed with the proposed model. The result is presented in Table 3.

Multiple Regression Analysis

Hypothesis testing is performed with multiple regression analysis to examine the

Table 2.
Descriptive Statistics

Panel A: Continuous Variables				
Variable	Mean	Std. Dev.	Min	Max
IEDI	5.447	0.501	3.1	6.85
ECO_EXP	13.035	0.536	11.509	14.936
WEALTH	28.556	0.615	27.144	31.387
SPV	2.779	0.563	0.617	3.904
UNEMP	0.036	0.019	0	0.097
POV	0.12	0.082	0	1.05
HDI	66.217	7.864	19.62	86.65
Panel B: Dummy Variables				
Variable	Dummy 0		Dummy 1	
	Freq.	Percentage	Freq.	Percentage
GEO	343	76%	109	24%
TYPE	364	81%	88	19%

determinants of inclusive economic development, especially whether local government has contributed to inclusive economic development through economic function spending realization, the use of local wealth, and supervision. Our analysis reveals that local government economic function spending and local wealth have no significant effect on inclusive economic development, while local government supervision exhibits a positive effect. Thus, larger government economic function spending per capita and local wealth do not significantly contribute to improving inclusive economic development.

Meanwhile, local government supervision has proven to be an important aspect of achieving inclusive economic development. We conducted subsample analysis by classifying the local government based on type and geographical area and generated consistent empirical findings. We report the hypothesis testing and analysis results in Table 3.

Discussion

Local government spending on economic functions is evidenced to have no significant impact on inclusive economic development. The amount of spending



Graphic 1.
Spatial Analysis of Inclusive Economic Development in Indonesia

Table 3.
Multiple regression analysis - Overall

VARIABLES	(1) All LGs	(2) District LGs	(3) City LGs
ECO_EXP	-0.0047 (0.0352)	0.00511 (0.0398)	0.0216 (0.0797)
WEALTH	0.0253 (0.0295)	0.0780 (0.0357)	0.0424 (0.0583)
SPV	0.111*** (0.0260)	0.115*** (0.0278)	0.0360** (0.0744)
UNEMP	-0.234 (0.819)	-0.783 (0.941)	-0.854 (1.882)
POV	-0.919*** (0.183)	-0.869*** (0.183)	-1.317 (1.067)
HDI	0.0354*** (0.00274)	0.0355*** (0.00292)	0.0325*** (0.00789)
GEO	0.289*** (0.0333)	0.285*** (0.0384)	0.211*** (0.0787)
TYPE	0.298*** (0.0436)	-	-
Constant	2.067*** (0.681)	0.432 (0.891)	4.505*** (1.176)
Observations	452	364	88
R-squared	0.709	0.601	0.313

realized per capita in economic function has no significant contribution to improving inclusive economic development in local government. The insignificant effect may arise due to the issue of government spending quality in Indonesia. There are still substantial issues in the form of budget leaks (Paranata, 2022) and inefficient spending (Wardhani, Rossieta & Martani, 2017) that start from the budget plan with unnecessary activities that contain several irrelevant outputs and under-expected outcomes. When the spending issue starts with the budget, it becomes complex (Prabowo, Leung & Guthrie, 2017) because when the budget has been stated with certain activities, these activities should be implemented. In addition, the amount of spending may also be inadequate and cannot cover the realization of local development targets. According to Sriyana (2016), the amount of government spending should be optimal so that it can have an impact on economic growth.

It is urgent to tackle the existing government spending issues with the spending better principle to ensure that the government programs stated in the budget are well planned, followed by proper realization following the value for money principle: economic, efficient, and effective (McKevitt, 2015). Therefore, government spending can result in the desired development outcomes, specifically economic function spending to increase inclusive economic development across all local governments in Indonesia. In regards to previous studies, the finding is also in line with the study from Sriyana (2016), which demonstrated that Indonesia still spends money but has not been able to deliver a significant impact on economic growth. Wardhani et al. (2017) also state that government spending is still inefficient and does not improve government performance. Handayani, Suharno & Badriah, (2022) even discover that economic function spending is related to higher poverty, implying that economic function spending is still not optimal.

In regard to local wealth, it is revealed that the effect of local wealth on inclusive

economic development is not significant. The amount of local wealth does not really contribute to the local government's goal of achieving more inclusive economic development. The insignificant effect is subject to the existing issues faced by the local governments in Indonesia related to the utilization of assets and the maximization of local potential (Sofyani, Riyadh & Fahlevi, 2020). In regards to the utilization of assets, many local governments are still unable to take optimum advantage of the assets that they control (Saragih, 2022). Although the utilization of assets has complied with the regulation (Tirayoh Latjandu, Sabijono, & Mintardjo, 2021), many local government assets are still idle or not used properly. Meanwhile, the assets can actually bring a lot of benefits for the local government, either in terms of creating financial revenue or supporting the operational activities of the local government (Bukit, 2020). Further, many local governments are still not able to maximize the local potential that can support economic development. The maximization of local potential is crucial for creating higher economic activities so that the local government can grow significantly in economic aspects. Finally, local wealth can support inclusive economic development.

The study finds that local government supervision positively affects inclusive economic development at the local level. The finding confirms the COSO concept that the implementation of internal control will support the achievement of government objectives (Winarna et al., 2021), specifically in economic development, ensure the safety of assets from corruption (Hasnawati & Amin, 2020; Maulidi & Ansell, 2022), and comply with the regulation (Graham, 2015). The result is also related to the previous findings related to local spending and local wealth. Despite the fact that financial resource usage has not been contributed enough, supervision remains an important factor in optimizing the implementation of government programs (Saragih, 2022) with the existing resources that the local government has. Therefore, it has

significantly contributed to the achievement of inclusive economic development, although there are still various issues related to financial resources aspects. Supervision should be optimized even more to support the realization and utilization of local wealth. In supporting the spending, supervision must be implemented from budget planning and budget realization to ensure the achievement of programs' outputs and outcomes. In regards to local wealth utilization, the internal auditors can help analyze the existing idle assets and the unoptimized ones that can be useful to support government programs.

CONCLUSION

Following the inclusiveness issue in economic development that still emerges in Indonesia, the study attempts to present empirical evidence of the determinants of inclusive economic development, specifically from local government contributions. We overall discover that most local governments have reached satisfactory levels of inclusive economic development achievement based on the data from BAPPENAS. Meanwhile, the local governments in East Indonesia still need to improve to catch up with the gap that still exists between them and their counterparts in West Indonesia and make the level of development even more inclusive. Our empirical investigation reveals that local government financial resources have not significantly contributed to improving inclusive economic development at the local level, as indicated by the insignificant effect of local government economic function development on local wealth. Meanwhile, the supervision conducted by the local government demonstrates a positive effect on inclusive economic development, proving that the role of government in safeguarding the public interest is crucial to supporting the inclusive economic development agenda.

LIMITATIONS AND SUGGESTIONS

The study is limited in terms of observation scope. Despite covering most Indonesian local governments as research

observation, the research period is limited to only one year, which is the 2019 fiscal year. Future researchers can conduct a longitudinal study that covers a longer observation period. Another limitation of the study is that it has not controlled for local government infrastructure and demographic characteristics. These characteristics must be taken into consideration as control variables in future studies. In addition, ensuring that the model is free from endogeneity issues is also suggested for future studies, as the study may not have sufficiently controlled this issue. The study provides several suggestions in the form of practical implications for local governments to increase their role in supporting inclusive economic development. Firstly, it is urgent for local governments to increase the quality of their spending through planning and budgeting with accountable programs that are followed with good realization to really produce impressive development outcomes. Secondly, local governments are suggested to dig deep into the potential of local wealth by optimizing asset utilization both in supporting operational activities and generating financial returns to fund more development programs. Lastly, local governments also need to maintain good supervision over the implementation of government programs, both in terms of operational procedures and financial resource usage. Finally, it can be expected that inclusive economic development can be accomplished for all local governments in Indonesia.

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