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Analysis of Financing and Poverty on Economic Growth in Indonesia

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ABSTRACT
The causal relationships among financing from various Islamic Banks, poverty and economic growth are the objectives in this research. Panel data is the appropriate model applied in this research. The data are collected from all provinces in Indonesia from 2011-2017 to seek the causal relationship. We find that disbursement of Islamic Commercial Banks financing significantly leaven Indonesian economic growth. However, it is also depicting unpleasant picture as most provinces unfortunately still lied in second, third and last quadrants rather than in the first quadrant. We also argue that our finding attests financing from various Islamic Banks can spur Indonesian economic development. Poverty attests conversely as it clearly lead to prejudice the economy. The research also provides some suggestions such as the government and its related agencies should concentrate in increasing funding to grow a higher economy and they are urged to create such policy in order to manage the level of poverty.

Keywords: *Financing, Poverty, and Panel Data.*

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INTRODUCTION

Economic growth is actually considered as one of the important indicators to measure the progress or welfare of a country. In general, macro indicators such as inflation, human development index, poverty, unemployment, domestic income, are considered as the direct factor affecting an economy as a whole.

Furthermore, economic growth is also influenced by other factors categorized as indirect factors. Boldeanu and Constantinescu [1] believed that indirect factors are also standing as prominent indicators influencing economic growth. They are related to financial institutions, and others, savings rates, aggregate demand size, investment levels, government efficiency, budget and fiscal policies, labor and capital migration. Thus, they are generally linked with financing.

Islamic Banking Financing is a normal business activity just like ordinary credit from conventional banking system carried out by the financial sector with a special feature of which is in accordance with the Islamic economic system. Prastowo [2] believed that Islamic Banking Financing acts as an alternative way in all of the type of transactions based on the profit and risk sharing. The progress of Islamic Banking Financing as an alternative way compared with the classic conventional banking credit in the Indonesian context is relatively swift. Furqani and Mulyani [3] argued this progress, at least, was promoted by demand and supply, thus eventually will improve economic growth. It is not surprising as almost all provinces in Indonesia perform this financing activity hitherto. The Islamic Banking Financing velocity both in the short and long run is supposed to proficiently provide sustainable solutions [4].

Sharia Banking Statistics reveals the total sharia bank offices, namely Sharia Commercial Banks (BUS), Sharia Business Units (UUS) and Syariah People's Financing Banks (BPRS), until August 2018 have reached 2470 offices disperse widely in Indonesia. Furthermore, total Islamic Banking financing disbursement have reached 303.5 Trillion Rupiah until August 2018. 27.65% total Islamic Banking financing was channeled for working capital financing, meanwhile another 21.87% was channeled for investment financing, the rest was channeled for consumption financing. Unfortunately an important sector such as education can only absorb 1.69% from total Islamic Banking financing disbursement. Indonesia Statistical Bureau, BPS Indonesia, reveals an increase in total number of Islamic Banking financing in Indonesia from 2010-2017 [5].

Table 1: Average Economic Growth, Financing and Poverty 2010-2017

Year	Economic Growth (%)	Investment Financing (in billion Rp)	Poverty (%)
2010	6.85	2,494	14.43

2011	4.16	8,484	13.21
2012	4.41	17,219	12.65
2013	4.33	23,213	12.08
2015	4.15	12.003	11.85
2016	3.78	29.318	11.51
2017	3.61	32.916	11.32

Source: OJK and Bureau Central Statistics Indonesia, 2010-2017

There is a declining economic growth trend in Indonesia as seen from table 1. Financing, however, progresses to increase. Poverty trend over the same period of time also decreases in accordance with Indonesian economic growth. The decline, however, is even swifter compared with the the economic growth rate, although it inclines to fluctuate, not much different from variation in the development of economy among provinces. This circumstance depicts the financing contribution toward the development of Indonesian economy.

LITERATUR REVIEW

The Impact of Islamic Banking Financing on Economic Growth

Muhamad Abduh and Mohd Azmi Omar [6] argued that there is exist a significant dynamical nexus between Islamic Banking Financing and Indonesian economic growth in short-run and long-run. The relationship is a bi-directional both in Schumpeter's supply-leading and Robinson's demand-following.

Another researcher employing a cointegration test and vector error correction model, Furqani and Mulyany [3] appraised the dynamical nexus between Islamic Banking Financing and Malaysian economic growth. Their findings depicted that from 1997:1 until 2005:4, only the fixed investment variable granger cause Financing. However, they found a bi-directional nexus between Malaysian Islamic Banking Financing and fixed investment in Malaysia in the long run. Their findings also depicted an augment in GDP would develop Islamic Banking Financing but an advance in Islamic Banking Financing unfortunately did not improve GDP .

Using error correction models and the bound testing approach of cointegration developed in ARDL framework, Farahani and Sadr [7] investigated the nexus between Islamic Banking Financing and economic growth in Iran and Indonesia. They found a significant nexus between Islamic Banking Financing and economic growth in both countries.

Using the panel cointegration approach models framework, Farahani and Dastan [8] explored the nexus between Islamic Banking Financing and economic growth in several countries. Their study findings depicted a positive and significant relationship within these examined countries. They also depicted an evidence it was stronger in the long run in contrast with the short run.

The Impact of Poverty on Economic Growth

The supremely powerful instrument to eradicate poverty is the degree of the economic growth. Economic growth in developing countries stands as a prominent instrument in eradicating poverty and also improving the quality of life. Many studies, both cross-country and country case research, provide extraordinary evidence such as fast and sustainable economic growth is particularly something prominent to eradicate poverty, especially for people whose revenue less than $ 1 per day and give a boost to progress towards achieving the Millennium Development Goals [9].

Research performed by Lin [10] proved that the China has thrived in lowering 450 million population out of poverty trap since 1979. He pointed out the China high level of economic growth between 1985 and 2001 was a prominent factor of which helps to bring down poverty.

HBhanumurthy and Hmitra [11] argued India has thrived in eradicating poverty significantly since the 1980s and the rate was augmented substantialy in the 1990s. It was cohesive to India's impressive high level of economic growth during this period. Arndt et al. [12] revealed the triumph story of Mozambique in alleviating poverty swiftly that was directly accorded to the growth of country's economy. The growth of Mozambique economy was increased by 62 percent from 1996 to 2002 and Mozambique managed in alleviating the proportion of poor population from 69 percent down to only 5 percent left.

Ravallion [13] also proved that in countries with a low level of income gap, each one percent incramental of a national income will diminish poverty by 4.3 percent. However, in countries with a high level level of income gap, it would only decrease approximately 0.6 percent.

METHODOLOGY

The quadrant approach as well as panel model are applied in the research consisting of all provinces in Indonesia from 2011-2017 with approximately 231 observations in total. The imprimis approach, i.e. quadrant approach, is a technique applied to elaborate positions, for example, higher or lower level of Islamic Banking Financing and economic growth. Panel model is applied after the quadrant approach is done. The variables' description and also the research operational definitions are scheduled in Table 2:

Table 2: Description of Variables

Variables	Symbol	Description	Correlation	Source
Economic growth	Eco	2010 ADHK Economic growth rate (percent)	NA	https://www.bps.go.id/
Financing	LnF	The amount of Financing channeled by banks in units of Rupiah (Natural Logarithm)	+	www.ojk.go.id
Poverty	Poverty	32.916	-	https://www.bps.go.id/

Source: OJK and Bureau Central Statistics Indonesia, 2010-2017

Applying panel model, the research attempts to seek the influence of Islamic Banking Financing and other variables on Indonesian economic growth 2011-2017. Panel data model actually provides many statistical as well as economic theory benefits such as enlarging degrees of freedom, informative data, more efficient, and reducing colinearity between variables. It also enables to elaborate many crucial economic problems cannot be answered by time series or cross section model. It is also proficient to calculate the degree of heterogeneity as a unique characteristic of intertemporal individuals and also higher degree of flexibility in modeling behavioral discrepancies between individuals contrast to cross section model [14].

Making estimation using panel model approach, at least 3 types of models could be performed, namely pooled least square, fixed effect model, and random effect model. However, in order to choose the most appropriate model, Chow test and Hausman test is implemented. Whether a fixed effect model or a pooled least square model is better then the Chow test was applied. If the score Chi square indicated as significant then the fixed effect model should be chosen build upon this test. On the contrary, if the common effect model is the best model build upon this test then no other tests are needed. Hausman test then is applied following the Chow test. It is performed to opt a more suitable model wheter a fixed effect model or a random effect. Random effect model is a more suitable model when the Chi square cross section is not significant, otherwise, a fixed effect model is considered as the best model. Thus this research empirical model will be as follow:

$$Eco_{it} = \beta_0 + \beta_1 LnF_{it} + LnPoverty_{it} + e_{it} .$$

RESULTS AND DISCUSSION

Data description-

This part explains the Indonesian 33 provinces economic growth. Initially economic growth is determined then put into specific quadrants along side with Islamic Banking Financing as seen in Table 3.

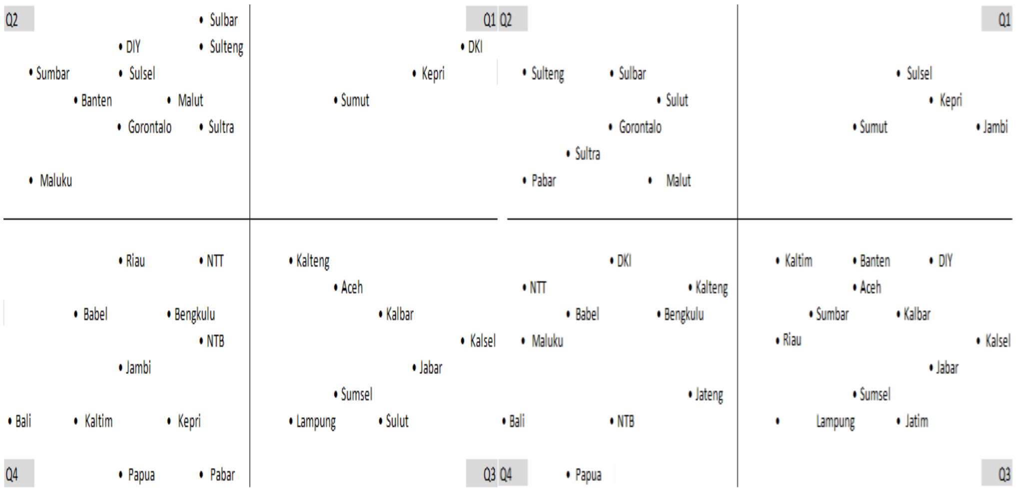
Table 3: Relationship of Economic Growth with Financing

Quadrant	Economic growth	Financing
I	High	High
II	High	Low
III	Low	High
IV	Low	Low

Source: OJK and Bureau Central Statistics Indonesia, 2010-2017

Relationship between Islamic Banking Financing and Economic Growth a Quadrant Approach

There are twenty one provinces are interchanged, where 9 provinces are considered better off, 8 provinces are considered worse off, and lastly, 4 provinces changed amongst variables. On the basis of region, in general, there is none of the province have entered the initial first quadrant in 2010. For Sulawesi and Bali regions Nusa Maluku and Papua lied in second quadrant, meanwhile Kalimantan, Java and Sumatra lied in third Quadrant. No provinces is actually lied in the last Quadrant. Furthermore, there are actually 12 provinces in which has BUS financing for investment yet their economic growth remain unchanged.



Source: OJK and Bureau Central Statistics Indonesia, 2010 and 2017

Figure 1. [1] Quadrant relationship between Financing and Economic Growth, Provinces in Indonesia, 2010 and 2017

The Java island is the only island that shows not only experienced high degree of Islamic Banking Financing but also having a high degree of economic growth in 2017. This region is developing well so it was located in first quadrant I in 2017 as the result moving up from third quadrant in 2010. Sulawesi region was unfortnately stayed steady in seconf quadrant II, in terms of Islamic Banking Financing and economic growth, over the same juncture. Meanwhile Bali, Nusa Maluku and Papua are worse off falling down into the fourth quadrant. Furthermore, the islands that experienced illumination were the Kalimantan and Sumatra islands from the third quadrant plunged into the fourth quadrant.

Relationship between Poverty and Economic Growth

The mean Human Development Index (HDI) score from 2010 to 2017 has reached 66.97. As shown in table 3, the HDI value was 63.68 in 2010 and increased to 69.76 in 2019 with a mean of growth approximately 1.31 percent. Furthermore, as recorded, the humblest HDI happened to occur in Papua Province by 59.09 point in 2017 and the top HDI score was happened to occur in DKI Jakarta by 80.06. The expected mean HDI in all Indonesian provinces will then be approximately 74.45 in 2022.

The Indonesian poverty level as measured at the provincial stage, tends to decline from 2010 to 2017. On average the poverty rate in all Indonesia provinces was approximately 14 percent in 2010 and then declined in 2017 into approximately 11.32 percent with a mean of 12.15 percent from 2010 to 2017. The mean of predicted poverty rate in 2022 will approximately be 9.72 percent. Papua Province is predicted as the island with the uppermost poverty rate approximately by 27.62 percent meanwhile DKI Jakarta is predicted as province with the lowermost poverty rate approximately by 3.77 percent.

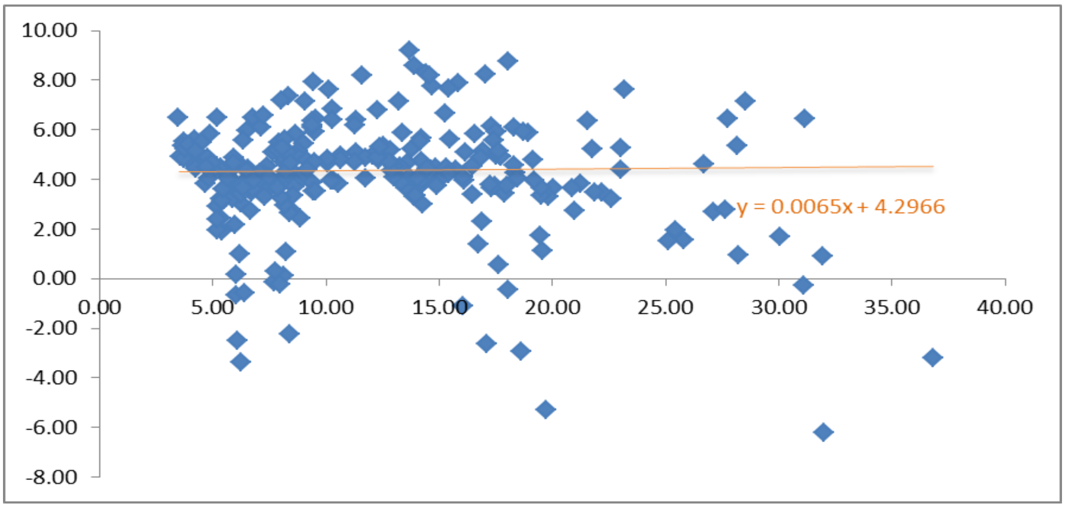
Table 3: The Condition of Human Development Index and Poverty with Economic Growth in Provinces in Indonesia, 2010 and 2017

No	Provinsi	Indeks Pembangunan Manusia (%)		Kemiskinan (%)		Penduduk Miskin		Pertumbuhan Ekonomi (%)	
		2010	2017	2010	2017	2010	2017	2010	2017
1	Aceh	67.09	70.60	20.98	16.89	861.85	872.61	2.74	2.32
2	Sumut	67.09	70.57	11.31	10.22	1,490.89	1,453.87	6.42	3.95
3	Sumbar	67.25	71.24	9.50	6.87	430.02	364.51	5.94	4.06
4	Riau	68.65	71.79	8.65	7.78	500.26	514.62	4.21	0.29
5	Jambi	65.39	69.99	8.34	8.19	241.61	286.55	7.35	2.97
6	Sumsel	64.44	68.86	15.47	13.19	1,125.73	1,086.92	5.63	4.15
7	Bengkulu	65.35	69.95	18.30	16.45	324.93	316.98	6.10	3.39
8	Lampung	63.71	68.25	18.94	13.69	1,479.93	1,131.73	5.88	4.10

9	Babel	66.02	69.99	6.51	5.20	67.75	74.09	5.99	2.39
10	Kepri	71.13	74.45	8.05	6.06	129.66	125.37	7.19	-0.66
11	DKI	76.31	80.06	3.48	3.77	312.18	389.69	6.50	5.23
12	Jabar	66.15	70.69	11.27	8.71	4,773.72	4,168.44	6.20	3.84
13	Jateng	66.08	70.52	16.56	13.01	5,369.16	4,450.72	5.84	4.53
14	DIY	75.37	78.89	16.83	13.02	577.30	488.53	4.88	4.11
15	Jatim	65.36	70.27	15.26	11.77	5,529.30	4,617.01	6.68	4.86
16	Banten	67.54	71.42	7.16	5.45	758.16	675.04	6.11	3.63
17	Bali	70.10	74.30	4.88	4.25	174.93	180.13	5.83	4.44
18	NTB	61.16	66.58	21.55	16.07	1,009.35	793.78	6.35	-1.09
19	NTT	59.21	63.73	23.03	21.85	1,014.09	1,150.79	5.25	3.50
20	KalBar	61.97	66.26	9.02	7.88	428.76	387.43	5.47	3.66
21	Kalteng	65.96	69.79	6.77	5.37	164.22	139.16	6.50	4.48
22	Kalsel	65.96	69.79	5.21	4.73	181.96	193.92	6.50	4.48
23	Kaltim	71.31	75.12	7.66	6.19	243.00	220.17	5.10	0.99
24	Sulut	67.83	71.66	9.10	8.10	206.72	198.88	7.16	5.28
25	Sulteng	63.29	68.11	18.07	14.14	474.99	417.87	8.74	5.53
26	Sulsel	66.00	70.34	11.60	9.38	913.43	813.07	8.19	6.20
27	Sultra	65.99	69.86	17.05	12.81	400.70	331.71	8.22	4.70
28	Gorontalo	62.65	67.01	23.19	17.65	209.89	205.37	7.63	5.15
29	Sulbar	59.74	64.30	13.58	11.30	141.33	149.76	11.89	4.71
30	Maluku	64.27	68.19	27.74	18.45	378.63	320.51	6.47	4.05
31	Malut	62.79	67.20	9.42	6.35	91.07	76.47	7.95	5.59
32	Pabar	59.60	62.99	34.88	25.10	256.25	228.38	28.47	1.51
33	Papua	54.45	59.09	36.80	27.62	761.62	897.69	-3.19	2.79
Total		2,165.21	2,301.86	476.16	377.51	31,023.39	27,721.77	6.85	3.61

Source: OJK and Bureau Central Statistics Indonesia, 2010-2017 (data processed)

Poverty rate has a positive correlation with economic growth. Thus, it exhibits that Indonesia's economic development has a contradiction situation with alleviating poverty efforts. Then this condition represents that despite of Indonesia's economic development, it still is deficient to strengthen micro businesses and also on the poor empowerment. Programs such as populist economic program thay could encourage the poor to augment their income is needed. They eventually are envisaged to be independent and empowered so that they could manage to escape from poverty.



Source: OJK and Bureau Central Statistics Indonesia, 2010-2017 (data processed)

Figure 2. Trend of Poverty Relations with Economic Growth 2010 – 2017

The Effect of Financing and Poverty on Economic Growth in Indonesia

Build upon table 4, the equation model will then be: Eco = -4.717843 + 0.359464F - 0.086718 Poverty. It simply reveals the Islamic Banking Financing has a positive and significant influence on Indonesian economic growth. If Islamic Banking are capable to channel its financing for investment just by 1 percent, it will accelerate approximately 0.36 percent (ceteris paribus) of Indonesian economic growth. The analysis above is in accordance with research performed by Rihab Grassa, Kaouthar Gazdar in analyzing the effect of conventional as well as Islamic financial development on five GCC countries' economic growth from 1996-2011. They found that conventional finance has a negative and significant influence on their economic development. The development of Islamic banking sector, on the contrary, possesses a positif and significant influence on their economic growth.

Table 4: Results of Financing and Poverty regression on Economic Growth

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNF	0,359464	0,086782	4,142153	0,0000
Poverty	-0,086718	0,021363	-4,059228	0,0001
C	-4,717843	2,548346	-1,851335	0,0653
R-squared	0.261726	Mean dependent var	4.265295	
Adjusted R-squared	0.235567	S.D. dependent var	2.391895	
S.E. of regression	2.091279	Akaike info criterion	4.350571	
Sum squared resid	1110.856	Schwarz criterion	4.486024	
Log likelihood	-564.2754	Hannan-Quinn criter.	4.405000	
F-statistic	10.00507	Durbin-Watson stat	2.073659	
Prob(F-statistic)	0.000000			
Uji Chow with Redundant Fixed Effects Tests : 7***				
Uji Hausman with Correlated Random Effects : 15***				

Source: OJK and Bureau Central Statistics Indonesia, 2010-2017 (data processed)

Another finding in this study is also similar to the effect of Islamic banking in several MENA countries, although the development of Islamic banking is still hampered by the domestic rules established by the institutions of which holds responsibility and authority within their countries. Similar findings from Pakistan also exhibit a positive and significant long-term and dynamic two-way causal nexus between real economic activities and Islamic banking. The State Bank of Pakistan is urged to proceed encouraging Islamic banking as a banking system parallel to the conventional system, as Islamic banking proved to have a prominent positive effectct on Pakistan's real economic activity. A more detailed research of the nexus between Islamic banking system and economic growth done in Malaysia, Indonesia and Jordan. A series of Islamic finance such as muḍārabah, mushārakah, murābaḥa, 'istiṣnā,' ijārah, as expected, has a prominent impact on both economic growth as well as Islamic financial intermediation. Meanwhile, credit for the private sector and liquid liabilities do have not an effect on Islamic financial intermediation. In developing countries, empirical investigations reveal the development of Islamic banking (non-usury banks) actually enhances economic growth. Furthermore, a cooperation of the two means of financing would contribute to an increase in economic growth. This new funding integration has never ignored the substantial role of conventional financing methods.

Another research carried out in Turkey in which showed that the role of Islamic banking unfortunately was not significant. The financing disbursed by Islamic banking did not possess a significant influence on the development of the Turkey's economy and industry. The main reason for this result is the small percentage of sharia banking in the overall banking system in Turkey. They suggest the role of sharia banking should be increased in order to contribute more to the country's economy. This result is similar to the findings of this study in which financing for non-investment from Islamic banking actually reduces economic growth.

An interesting phenomenon is found in poverty, of which is an important determinant in economic growth. Indeed, poverty within a society can disrupt the economy due to the limited population activities in the economiy. In this study, poverty can cause the decline of economic growth.

If poverty increases by 1 percent, then economic growth will decrease by 0.04 percent (assuming other factors are hold constant). How did this happen? It is a common phenomenon found in this study. It is suspected that a high level of poverty in the early period of 2011-2017 was accompanied by a high decline in the economic growth, as a result of other determining variables. Just before the period of 2016-2017 poverty has reduced and is also accompanied by a slowdown in economic growth, in this case we cannot avoid other economic growth factors. On the other hand the underdeveloped regional conditions in where there still have a great poverty, coupled with the low of economic growth. Therefore it is necessary to pay attention more to this variable to improve regional economic growth.

Most people in almost all of provinces in Indonesia have their livelihoods in the agricultural sector. Thus, the progress in this particular sector is seen as a panacea for poverty alleviation, especially in developing countries. Similar studies empirically investigate the dynamic relationship between agricultural value added and poverty reduction of nine countries in South Africa using a second generation panel approach for the period 1990 until 2015. The results show agricultural development is needed but insufficient policies to eradicate poverty because it can only run in the short run. Therefore, it is recommended a long-term economic program and/or strategy of which will complement agricultural development towards poverty alleviation to enhance economic growth in the sample area.

It is important to be aware of the contradiction in which economic growth actually has a slight reduction in poverty in all regions when income inequality is relatively high rather than the lower income inequality region. The study examines and compares the implications of economic growth on poverty and income inequality among 76 countries across sub-Saharan Africa (SSA), South and East Asia (SEA), Latin American countries (LAC) and the OECD region for the period 1990 until 2010. Economic growth significantly reduces income inequality in SSA. However, growth has led to increasing income inequality in the LAC and OCED regions.

The same result was also found in a study using panel data for the Brazilian state from 1995 until 2009 in analyzing the impact of economic growth and income inequality on poverty, in which seeks to evaluate Bourguignon's hypothesis that the more uneual a country, the less effective economic growth in reducing poverty. The results of the estimated model lead to the conclusion of which the effect of income growth on poverty eradication is smaller when the initial lower level of development. The same conclusion is also true when the initial higher level of inequality. Therefore, regions with an initial lower development rates, the initial higher inequality or combination of both conditions provide unfavorable conditions for alleviating poverty through income growth.

The large variation among provinces in Indonesia can hamper the effectiveness of economic growth due to poverty. According to Skare and Druzeta, identically similar growth patterns may have different effects on poverty aleviation. Growth is good condition for poverty eradication but not sufficient. To what extent the growth could reduce poverty,it depends on many factors, for instance, how do we measure poverty, the absorption capacity of the poor, the velocity and pattern of growth. As the rich get richer and the poor get poorer, the "trickle down" effect becomes a scenario that needs to be reviewed.

CONCLUSION

The Indonesia economic growth as shown in our findings are significantly influenced by Islamic Banking Financing as well as poverty. Our findings demonstrate that Indonesian economic growth will be positively influenced by a higher extent of Islamic Banking Financing. Thus, encouraging Indonesian economic growth could be done by also developing

Islamic banking financing. Meanwhile, Indonesia economic growth will be negatively influenced by a raise in poverty. The results also exhibit Indonesia's provinces were majority still stood in quadrants II, III and IV. It demonstrates the relatively low allocation of Islamic Banking financing in each respective provinces. The government is urged to establish regulations in favor of business actors such as tax breaks and business licenses. The local governments are urged to put regional development funds into Islamic Commercial Banks.

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