Exploring the Nexus between Regional Fiscal Capacity and the Convergence of Inclusive Economic Development

Rachmad Kresna Sakti1*, Nugroho Suryo Bintoro2, Axellina Muara Setyanti3, Rahayu Anzelina Agustin4

1 Department of Economics, Universitas Brawijaya, Indonesia
2 Department of Economics, Universitas Brawijaya, Indonesia
3 Department of Economics, Universitas Brawijaya, Indonesia
4 Department of Economics, Universitas Brawijaya, Indonesia

*Corresponding Author Email: kresna@ub.ac.id

Received: 18 November 2023; Revised: 27 December 2023; Accepted: 1 January 2024

Abstract

In the fiscal decentralisation system, the establishment of fiscal capacity is of paramount importance as local governments must be capable of effectively managing their own financial resources to meet the needs of the local population and advance regional development. Possessing a robust fiscal capacity enables local governments to be more effective in enhancing regional economic growth. This study analyses the influence of regional fiscal capacity on the convergence of inclusive economic development across 34 provinces in Indonesia. Conditional beta convergence analysis is employed on the Inclusive Economic Development Index, which is influenced by the degree of fiscal decentralisation, local financial autonomy, effectiveness of local own-source revenue, indirect expenditure ratio and direct expenditure ratio. This study provides valuable insights revealing visible convergence trends among Indonesia’s 34 provinces indicating crucial progress in achieving inclusive economic development and eliminating inequality. Furthermore, the observed progress underlines the vital role of fiscal capacity, particularly the levels of fiscal decentralisation and direct spending, as a significant driver encouraging a positive trajectory of economic convergence between provinces.

Keywords: Convergence Analysis; Fiscal Capacity; Inclusive Economic Development

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Permalink/DOI: https://doi.org/10.46507/jcppp.v5i1.261
Introduction

Inclusive economic development is a concept emphasising economic progress that involves the entire society, including less fortunate or marginalised segments. Its primary objective is to achieve sustainable economic growth and social justice (Badrudin et al., 2018; Ost, 2018). The concept of inclusive development surfaced in the 21st century and has been incorporated into numerous academic and policy publications. Inclusive economic development acknowledges that everyone has an equal right to participate in economic development and enjoy its outcomes. In this framework, government, the private sector and the community must collaborate to create employment opportunities, develop infrastructure, provide access to necessary resources and enhance the overall quality of life for all citizens (Cabeza-García et al., 2019). By fostering an environment that promotes inclusiveness, a country can optimise the potential of all its citizens, enhance economic productivity and diminish social and economic disparities. Countries can also strengthen the foundation of sustainability and achieve more sustainable development in the long run.

In the context of the global south, the pursuit of inclusive economic development often entails endeavours aimed at mitigating economic disparities, expanding access to economic opportunities and enhancing the overall well-being of diverse societal strata. Regarding the Association of Southeast Asian Nations (ASEAN), for example, Alekhina and Ganelli (2023) stated that the area has experienced rapid economic growth accompanied by a dramatic fall in poverty rates, but income inequality has not improved much. Therefore, the authors attempted to identify factors that would contribute to more inclusive growth in ASEAN. Their findings revealed that fiscal redistribution, female labour force participation, productivity growth, FDI inflows, digitalisation and savings significantly drive inclusive growth (Alekhina & Ganelli, 2023).

Several nations, such as ASEAN country members, however, have found it challenging to sustain swift economic expansion following a significant leap. These countries often encounter the dilemma known as the ‘middle-income trap’. Vietnam, for example, appears to stand at a crucial juncture in this regard. Developing countries, including Vietnam, have successfully implemented inclusive policies emphasising the advancement of economically empowering areas such as micro, small and medium enterprises, vocational education to augment workforce skills and sectors such as agriculture (Tran et al., 2020). In another example, Malaysia has also focused on shifting to the challenges of poverty and achieving sustainable improvements in individual and societal well-being. In particular, Malaysia has encouraged inclusive growth through access to quality education, providing comprehensive social protection, raising the labour force participation rate of women and older persons, maintaining universal access to quality public healthcare and improving pension system sustainability (Nixon et al., 2017). Several other studies in developing countries have yielded similar conclusions, for instance, Rigg (2023) and Fleischer et al. (2018) in Thailand, Mitra and Das (2018) in India, and Munir and Ullah (2018) in Pakistan. Along with the examples of country cases above, analysis in the Indonesian context is particularly important.
Figure 1. Inclusive Economic Development Index in Indonesian Provinces 2021
Source: BAPPENAS (2022)

Figure 1 provides an interesting picture of the comparison of inclusive economic development conditions among provinces in Indonesia. In this context, the Inclusive Economic Development Index (IEDI) is a useful tool for assessing the extent to which each province in Indonesia has succeeded in achieving inclusiveness in its economic development. Daerah Khusus Ibukota Jakarta (DKI Jakarta; Special Capital Region of Jakarta) stands out as the leader with the highest index achievement, namely 7.93. DKI Jakarta’s success may be reflected in various development initiatives prioritising equal access and economic opportunities for all its people. This success is unsurprising as DKI Jakarta is the nation’s capital and the centre of the national economy, therefore, the main focus of economic development. The presence of international financial, business and trade centres in Jakarta creates considerable economic opportunities. Jakarta also has relatively better infrastructure compared to some other provinces. Furthermore, Riau Islands Province and Daerah Istimewa Yogyakarta (DI Yogyakarta; Special Region of Yogyakarta) were ranked second and third with scores of 6.66 and 6.63, respectively. The high achievements of these two provinces demonstrate the regional governments’ commitments to increase the inclusiveness of economic development, both through economic empowerment programmes and policies supporting a more equitable distribution of income.

In a positive development, Figure 1 shows that 22 of 34 provinces are above the national average, with a score of 6. This result reflects awareness and joint efforts to achieve inclusiveness in economic development at the provincial level. Moreover, this outcome provides a positive view of the diversity of development efforts in various regions, where each province has unique potential and challenges in achieving inclusive economic development. On the other side, it is essential to acknowledge the remaining
challenges hindering inclusive economic development across the remaining provinces. Disparities in infrastructure, educational opportunities and access to basic services remain significant barriers in some areas. This comparison can also be a basis for exchanging experiences and best practices between provinces to optimise equitable economic development throughout Indonesia.

A glimpse of inclusive development in Indonesia, coloured by a portrait of disparities between regions, highlights the urgency of a deeper understanding of the concept. Disparities in the economy, education and access to basic services are evidence that inclusive development efforts require attention to the following objectives. (1) Job creation: Inclusive economic development generates employment opportunities for all social strata, thereby reducing unemployment and poverty rates. (2) Reduction of social inequality: Involving the entire population in economic development mitigates social inequalities, fostering a more stable, harmonious and prosperous society. (3) Enhanced competitiveness: Inclusive economic development contributes to a country’s global competitiveness by involving the overall population in the economic development process. (4) Social conflict reduction: Inclusive economic development mitigates social conflicts as communities feel valued and empowered in the economic development process. (5) Promotion of sustainable economic growth: In the long term, inclusive economic development contributes to sustainable economic growth as the population as a whole participates in the economic development process (Juho & Ridhwan, 2023; Solechah & Sugito, 2023).

One of the key pillars supporting inclusive development is a local finance approach that takes into account and enhances fiscal capacity at the local level. These improvements provide a solid foundation for inclusiveness, where local financial policies and practices can directly support equitable economic development and improved welfare. By improving local financial capacity, local governments can more effectively allocate resources to support key sectors. The Anggaran Pendapatan dan Belanja Daerah (APBD; Regional Revenue and Expenditure Budget) crafted by local governments serves as an indicator of the government’s ability to manage regional finance (Halim, 2007; Rizkita et al., 2022).

At the onset of 2001, Indonesia experienced a significant fiscal decentralisation phenomenon, often referred to as the Big Bang decentralisation. This decentralisation transpired when the central government delegated numerous authorities and responsibilities to regional entities, including regional expenditures and partial authority in regional levies and local tax imposition. This change had a substantial impact on fiscal management at the district/city government levels, as the central government previously exercised centralised control over fiscal policies (Negara & Khoirunurrofik, 2021). After over two decades of the fiscal decentralisation era in Indonesia, it is imperative to examine the extent to which the development of fiscal decentralisation has influenced macroeconomic conditions. Good fiscal quality at the regional level is an influential factor, specifically through fiscal self-reliance (Dincecco & Katz, 2016; Dincecco & Prado, 2012). Achieving inclusive economic development through fiscal self-reliance involves managing public finances effectively, for example, increasing tax revenue, formulating
targeted budgets, strengthening public financial governance, empowering local economies, improving transparency and increasing accessibility to basic infrastructure (Sriyana, 2015).

Following Azizah et al. (2022), Setyowati et al. (2020), Oktavilia et al. (2020) and Saragih (2016), fiscal capacity in this study is measured using income and expenditure approaches and specific measurement ratios. For the measurement of regional financial performance, several ratio analyses can be performed based on data sourced from the regional budget (Mahmudi, 2010). These ratios include (1) the degree of fiscal decentralisation, representing the comparison between local own-source revenue and total regional revenue; (2) the ratio of financial independence, representing the comparison between local own-source revenue and central or provincial government assistance and loans; (3) direct and indirect expenditure ratios, indicating the proportion of direct and indirect expenditures beneficial for the internal management interests of local government, specifically, cost and budget controls; and (4) the growth ratio, measuring the extent to which regional governments can sustain and enhance their achievements from period to period.

A research gap lies in the limited existing literature specifically analysing the influence of regional fiscal capacity on the convergence of inclusive economic development across the 34 provinces of Indonesia. While there have been studies on fiscal decentralisation and its impact on economic growth (Aprianti & Sulindrina, 2023; Baskaran & Feld, 2013; Canavire-Bacarreza et al., 2020; Jamil et al., 2022; Lamba et al., 2019), there is a necessity to further investigate the relationship between regional fiscal capacity and the convergence of inclusive economic development. This research analyses the influence of regional fiscal capacity on the convergence of inclusive economic development across 34 provinces in Indonesia. In line with this objective, this study contributes to the literature by examining how regional fiscal capacity can contribute to achieving inclusive economic growth. Moreover, this study innovates by employing a data unit analysis of 34 provinces that combines fiscal self-reliance ratios and the IEDI released by Kementerian Perencanaan Pembangunan Nasional/Badan Perencanaan Pembangunan Nasional (BAPPENAS; Ministry of National Development Planning/National Development Planning Agency). Finally, this study explores how fiscal self-reliance in both revenues and regional expenditures influences the convergence of inclusive economic development in Indonesian provinces.

**Research Methods**

The method used in this research is panel data regression on provinces in Indonesia from 2017 to 2021, with data derived from secondary sources such as the IEDI released by BAPPENAS (2022) and regional financial data obtained from the Directorate General of Fiscal Balance of the Ministry of Finance. The convergence analysis model used in this study refers to the well-known convergence model developed by Barro and Sala-i-Martin (1991). More recent convergence models have also been used, for example, in Ram
This study uses the following conditional convergence model:

\[ \Delta \text{IEDI}_{it} = \beta_0 + \beta_1 \ln \text{IEDI}_{it-1} + \beta_2 \text{DFD}_{it} + \beta_3 \text{RFI}_{it} + \beta_4 \text{RGIE}_{it} + \beta_5 \text{IE}_{it} + \beta_6 \text{DE}_{it} \]

In this paper, \( \Delta \text{IEDI} \) reflects the per cent growth in the IEDI. \( \ln \text{IEDI}_{it-1} \) shows the natural logarithm of the previous year’s IEDI. As control variables in the conditional convergence model, we use the degree of fiscal decentralisation (DFD), regional financial independence ratio (RFI), regional-generated income effectiveness ratio (RGIE), indirect expenditure ratio (IE), and direct expenditure ratio (DE). Next, \( \beta_0 \) represents the constant, \( \beta_1 \) shows the convergence/divergence coefficient and \( \beta_2 \) to \( \beta_6 \) indicate the coefficient of independent variables that influence convergence. Each of the variables’ definitions is more clearly explained in Table 1.

Table 1. Definitions of Variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>Definition</th>
<th>Unit</th>
<th>Source: Processed by Authors (2023)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inclusive Economic Development Index (IEDI)</td>
<td>The IEDI index serves as a metric for measuring the inclusiveness of Indonesia’s development across national, provincial and district/city levels. This study uses provincial-level IEDI. The ‘degree of fiscal decentralisation’ is the financial capacity of local governments to finance regional expenditures. More specifically, the degree of fiscal decentralisation is the division between pendapatan asli daerah (PAD; regional-generated income) and total regional income.</td>
<td>Scale of 0–100</td>
<td></td>
</tr>
<tr>
<td>Degree of fiscal decentralisation (DFD)</td>
<td></td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>Regional financial independence ratio (RFI)</td>
<td>‘Regional financial independence’ is the ability of regional governments to finance their own governmental activities, development and services to the community who have paid taxes and levies as resources needed by the region. The regional financial independence ratio is the division between regional-generated income and central government assistance and loans. The effectiveness of PAD is assessed by the ability of the regional government to realise the planned PAD compared to the targets set based on the real potential of the region. The ‘regional-generated income effectiveness ratio’ is the division between the PAD target and the PAD realisation.</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>Regional-generated income effectiveness ratio (RGIE)</td>
<td>Indirect expenditures refer to regional spending actions that are planned in the budget and lack a direct correlation with the execution of programmes and activities. The ‘indirect expenditure ratio’ is calculated by dividing the indirect expenditure by the overall regional expenditure. Direct expenditures encompass regional spending initiatives outlined in the budget that are directly associated with the execution of regional government programmes and activities. Typically categorised into personnel, goods and services, and capital expenditures, this expenditure type is evaluated using the ‘direct expenditure ratio’, obtained by dividing the direct expenditure by the total regional expenditure.</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>Indirect expenditure ratio (IE)</td>
<td></td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>Direct expenditure ratio (DE)</td>
<td></td>
<td>%</td>
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</tbody>
</table>
Results and Discussion

Inclusive economic development is an approach aimed at engaging all segments of society in the process of economic growth, ensuring that the benefits are distributed equitably. The primary objective of inclusive economic development is a reduction in economic and social disparities among various societal groups. This development paradigm emphasises the creation of fair and sustainable economic opportunities, as well as providing better access to resources and economic facilities for all citizens, including those in vulnerable or less privileged groups (Cabeza-García et al., 2019; Ost, 2018; Stiglitz, 2002). The significance of inclusive economic development for a nation cannot be understated. Firstly, inclusive development helps alleviate poverty by providing economic opportunities to those who were previously marginalised (Iqbal & Khan, 2020; Muigua, 2020). By empowering all strata of society, a nation can create a broader consumer base, enhance purchasing power and stimulate sustainable economic growth. Secondly, inclusive economic development can mitigate social and economic inequalities (Gupta et al., 2015; Pouw & Gupta, 2017). By ensuring all citizens have equal access to education, training, employment and entrepreneurial opportunities, a nation can foster a more stable and equitable society. This objective not only establishes social justice but also enhances the country’s global competitiveness by optimising the potential of the nation’s overall human resources (Alizadeh, & Sharifi, 2023; Virjan et al., 2023).

Table 2. Inclusive Economic Development Index According to Three Pillars
Source: Processed by Authors (2023)

<table>
<thead>
<tr>
<th>National Scale</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>PILLAR 1: Economic Growth and Development</td>
<td>5.45</td>
<td>5.37</td>
<td>5.49</td>
<td>4.64</td>
<td>5.29</td>
</tr>
<tr>
<td>PILLAR 3: Expanding Access and Opportunity</td>
<td>5.89</td>
<td>5.98</td>
<td>6.43</td>
<td>6.62</td>
<td>7.06</td>
</tr>
<tr>
<td>Total IEDI</td>
<td>5.76</td>
<td>5.77</td>
<td>5.97</td>
<td>5.54</td>
<td>6.00</td>
</tr>
</tbody>
</table>

In Indonesia, the measurement of inclusivity in development is assessed through the IEDI and formulated based on three pillars: (1) economic growth and development, (2) income distribution and poverty reduction, and (3) the expansion of access and opportunities. The IEDI in Indonesia serves as a measurement tool encompassing these three primary pillars, reflecting a holistic approach to economic development. Table 2 illustrates the national progress of IEDI in Indonesia, showing an upward trend from 2017 to 2021. The first pillar, concerning economic growth and development, recorded a significant decline in 2020, decreasing from 5.49 to 4.64. This decrease is likely associated with the impact of the global COVID-19 pandemic during that year, affecting various economic sectors and causing a growth slowdown. Nevertheless, the measurement
provides a clear depiction of the interconnection between macroeconomic conditions and the level of inclusivity in development.

The second pillar of IEDI, focusing on income distribution and poverty reduction, signifies Indonesia’s commitment to addressing economic inequality. While not explicitly detailed in the description, the national increase in IEDI from 2011 to 2021 reflects efforts to reduce poverty levels and enhance income distribution. This pillar reflects a focus on social justice, providing insight into how the country strives to create a more inclusive society. The third and final pillar of IEDI is the expansion of access and opportunities to all segments of society, including those previously marginalised. With indicators showing the expansion of access and opportunities, it can be assumed that efforts have been made to increase the engagement of all citizens in various aspects of economic development. This objective aligns with the principle of inclusivity, emphasising that economic development should not solely benefit specific groups but should provide advantages to all citizens. The upward trend in IEDI scores from 2017 to 2021 implies positive overall progress in the inclusivity of economic development in Indonesia. This finding suggests that efforts have been made on a national level to enhance economic conditions in a way that benefits a broader spectrum of the population.

As shown in Figure 1, regional inequality remains a significant issue in Indonesia. The sources of inequality range from varying levels of development and resource endowments among Indonesia’s regions to the distribution of population and ethnicity (Aspinall & Berger, 2001; Sugiharti et al., 2023). How disparities between regions narrow over time is known as convergence (Borsi & Metiu, 2015; Farkas & Szabó, 2018; Marelli et al., 2019). ‘Regional convergence’ is the reduction of disparities in development indicators such as per capita income across different regions and its impact on reducing inequality. Over the past decade, regional convergence has been the subject of much research in Indonesia (Akita & Alisjahbana, 2002; Milanovic, 2005; Vidyattama, 2013).

‘Inclusive development convergence’ refers to the process in which various groups or regions that initially exhibit significant development disparities undergo a narrowing of these gaps. In this context, development is measured not only in terms of economic growth but also regarding inclusivity dimensions such as poverty reduction, income distribution and improved access to basic services (Bangura, 2019; Kamran et al., 2023; Liu et al., 2023). The concept encourages efforts and policies ensuring that the benefits of development are enjoyed equitably by all layers of society and regions. Regional development policies must be coherent and meet criteria to advance gradual convergence in per capita income on the one hand and simultaneously achieve convergence in social well-being on the other. However, economic convergence does not always imply social convergence, and vice versa (Rodríguez-Pose & Tselios, 2015; Hippe et al., 2024). The concept of inclusive economic development can address this potential disparity by creating income improvement along with social welfare enhancement.

The analysis of inclusive development convergence is crucial in the context of sustainable and equitable economic development. Narrowing development disparities among regions or societal groups can foster a more socially and economically balanced society. Convergence analysis assists governments and policymakers in identifying
regions or groups lagging in the development process, allowing for interventions and proper resource allocation to expedite growth and reduce disparities. We conducted conditional convergence calculations, the results of which are displayed in Table 3.

Table 3. Conditional Convergence Test Results
Source: Processed by Authors (2023)

| Variables | Coef.   | Robust Std Err | t     | p > |t| |
|-----------|---------|----------------|-------|-----|---|
| Ln_IEDI   | −1.2022 | 0.0765         | −15.71| 0.000* |  |
| DFD       | 0.0128  | 0.0024         | 5.19  | 0.000* |  |
| RFI       | −0.0003 | 0.0003         | −1.11 | 0.277 |  |
| RGIE      | −0.0001 | 0.0003         | −0.60 | 0.553 |  |
| IE        | 0.0002  | 0.0003         | 0.60  | 0.550 |  |
| DE        | −0.0012 | 0.0002         | −4.25 | 0.000* |  |
| Constant  | 1.7127  | 0.1380         | 12.40 | 0.000 |  |
| F stat    | 189.84  |                |       |      |  |
| Prob > F  | 0.000   |                |       |      |  |

Description: *significant at the 99% confidence level

Table 3 shows the results of conditional convergence testing on the IEDI influenced by several fiscal ratios (see Table 1 above): DFD, RFI, RGIE, IE and DE. The results indicate a tendency toward convergence among the 34 provinces in Indonesia. 'Conditional convergence' refers to the process where provinces initially having lower levels of inclusive economic development tend to grow faster than those with higher levels. This development is reflected in the negative and significant coefficients on the variable Ln_IEDI t − 1, indicating that provinces with a lower initial IEDI tend to experience faster growth than those with a higher initial IEDI. According to the neoclassical perspective, individual regional economies are anticipated to converge toward their respective stable states (Rodríguez-Pose & Tselios, 2015; Tselios, 2009). The notion posits that regions experiencing higher growth rates, particularly those characterised by lagging development and pronounced inequality, will undergo a process of catching up. Consequently, the neoclassical framework suggests that convergence across the income distribution spectrum will ensue, indicating not only a convergence in income growth rates but also a parallel convergence in the growth rates of income inequality (Rodríguez-Pose & Tselios, 2015; Tselios, 2009), meaning disparities will narrow further, making development more inclusive for many.

The interpretation of these findings indicates that efforts to enhance development inclusivity have a positive impact on reducing disparities among provinces. Provinces initially lagging in IEDI have the opportunity to catch up and even surpass more advanced provinces. These results can be interpreted as a positive response to policies and efforts...
to improve access and opportunities for the entire population, including vulnerable groups, in the economic development process. These results align with previous research by Amalia et al. (2018), Miranti and Mendez (2023), Solihin et al. (2021) and Vidyattama (2013), either at the national or subnational level. These studies stated that convergence in development would occur in Indonesia, though the influencing factors may differ from this study. The research finds changes in human capital and economic growth in Indonesia, indicating that regional convergence is occurring.

Although the presence of convergence has positive indications, challenges in development will persist. Sustainable and diversified policies are required to ensure the continuity of convergence. The government must continually promote investment in sectors that drive economic inclusivity, such as education, skills training and infrastructure development. Policy diversification is also necessary to address potential inequalities among provinces during the convergence process. The diversification of policy involves adopting a variety of strategic measures that move beyond a uniform, one-size-fits-all approach. It emphasises the need to customise policies to address the distinct challenges and opportunities inherent to each province, with the ultimate goal of ensuring an equitable distribution of development benefits. Each province in Indonesia possesses unique socioeconomic, cultural and geographical characteristics that contribute to its unique development challenges. Policy diversification recognises the necessity of tailoring interventions to address these specific challenges, acknowledging that a strategy effective in one region may not be equally applicable elsewhere. For instance, a province might face inadequate infrastructure that hampers economic growth. In this case, a tailored policy might involve a focused infrastructure development plan, including the construction of roads and utilities, to stimulate economic activities in that specific region.

Furthermore, Table 3 reveals that the convergence of inclusive economic development in the 34 provinces in Indonesia can be driven by regional fiscal capacity, specifically the DFD and the DE. It can be interpreted that regional fiscal capacity, measured through the growth of the decentralisation degree, can drive convergence in inclusive economic development in Indonesian provinces. The degree of decentralisation reflects the extent to which local governments have control over financial resources and decision-making at the local level. This study shows that a high level of decentralisation can provide flexibility to local governments to design and implement policies more in line with local characteristics and needs, including efforts to enhance inclusive development. Some previous studies also align with this finding, showing that the degree of decentralisation significantly influences development outcomes, such as economic growth (Alisman & Sufriadi, 2020; Nadeak et al., 2022), and income inequality.

Moreover, the finding that the ratio of direct spending contributes to the convergence of inclusive economic development (Table 3) aligns with the theory that direct spending, particularly in sectors such as health, education and other basic services, can help reduce disparities among regions (Gratia & Nugroho, 2020; Gulo et al., 2017; Yasni & Yulianto, 2020; Miar et al., 2024). Direct resource allocation for inclusive services and programmes can accelerate development in lagging regions. A high ratio of direct
spending reflects the commitment of local governments to provide equitable basic services, which in turn can promote inclusivity and stimulate even more economic growth. However, an excessively high ratio of direct spending can hinder economic development for several reasons that may have negative impacts on development sustainability and efficiency. If direct spending is not directed efficiently and does not maximally contribute to economic development goals, it can result in wasted resources and a failure to achieve expected outcomes.

Economic convergence theory supports these findings, suggesting that regions or countries with low levels of development tend to grow faster than those with high levels if there are supportive policies and conditions (Hall et al., 1997; Paprotny, 2021). Faster economic growth in initially lagging regions or provinces can trigger convergence in inclusive economic development. In this context, regional fiscal capacity and direct spending allocation become important policy instruments for achieving this convergence. Overall, strengthened regional fiscal capacity through the growth in the degree of decentralisation and the ratio of direct spending provides impetus for the convergence of inclusive economic development in Indonesian provinces. Enhanced regional fiscal capacity allows local governments to more effectively respond to local needs and allocate resources to regions requiring more attention. Concurrently, significant direct spending in key inclusive sectors can act as a catalyst for more even growth and a reduction in regional disparities. This finding has significant policy implications, emphasising the significance of strengthening regional fiscal capacity to support convergence in inclusive economic development in Indonesia.

**Conclusion**

The results of conditional convergence testing on the Inclusive Economic Development Index indicate a tendency toward convergence among the 34 provinces in Indonesia, suggesting a trend towards more equitable inclusive economic development across Indonesia. The growth of the fiscal decentralisation degree was found to play a role in driving the convergence of inclusive economic development in Indonesian provinces. This finding indicates that a high level of decentralisation provides local governments with the flexibility to design and implement policies more in line with local characteristics and the unique needs of each province, including efforts to enhance development inclusivity. The ratio of direct spending has also proven to contribute to the convergence of inclusive economic development. This finding aligns with the theoretical foundation that direct expenditures, particularly in health, education and other basic services, have the potential to reduce disparities among regions. The positive relationship between fiscal decentralisation, direct spending and the convergence of inclusive economic development highlights the pivotal role that local governance plays in shaping the economic landscape of provinces. Local governments should leverage these findings to refine and enhance their policies, ensuring that they are not only responsive to local needs but also contribute significantly to creating more inclusive and equitable societies.
Acknowledgement

We extend our sincere appreciation to the Department of Economics at Universitas Brawijaya, Indonesia, for their kind support and the provision of necessary resources crucial for the successful completion of this research. Their generosity and assistance have been instrumental in facilitating our study, enabling us to conduct thorough research and analysis. Without their support, this research would not have been possible.

Furthermore, we would like to express our gratitude to all individuals and organizations who participated in and contributed to this research. Their dedication, expertise, and willingness to collaborate have greatly enriched our study. From providing valuable insights to offering practical assistance, their contributions have significantly enhanced the quality and depth of our work.

Their collaboration and involvement have significantly enhanced the quality of our work. We are truly grateful for their commitment and partnership throughout this endeavor. Their collective efforts have not only advanced our research but also strengthened the bonds within our academic community. We look forward to future collaborations and the continued pursuit of knowledge and excellence.

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