The Effect of Sharia Bank Financing, Government Expenditures and Investment on Economy Growth in Indonesia

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ABSTRACT:

The objectives of this study is to analyze the influence of Islamic bank financing, government expenditure, and investment on economic growth in Indonesia. These three problems can be answered by the vector autoregressive model (VAR) and the vector error correction model (VECM). VAR/VECM is a type of macro-econometrics model that is commonly used to analyze economic fluctuations. In addition, researchers also have reasons for using this method, namely because of several advantages of this method. Islamic bank financing does not have a significant effect on economic growth in Indonesia. whereas, in the long term, Islamic bank financing has a significant and negative effect on economic growth with a coefficient value of -1.111488. This shows that in the long term, changes in Islamic bank financing will always be followed by changes in GDP in the reverse direction, meaning that if there is an increase of 1% in GDP, there will be a decrease of 1.11% in Islamic bank financing. In the short term, government spending has no significant effect on economic growth in Indonesia. whereas in the long run, government spending has a positive and significant influence on economic growth in Indonesia.

Keywords: islamic bank financing, government expenditure, investment, economic growth.

JEL Classification: G21; H50; H54; O4.

INTRODUCTION

When the global economy was experiencing a slowdown in 2019, Indonesia still showed positive economic growth of 5%. This proves that Indonesia has the strength to survive in uncertain conditions. The source of Indonesia's strength comes from two factors, namely the strength of investment and high public consumption.

An increase in a country's economic growth can be seen from increased economic activity from one period to the next. With an increase in economic growth from the previous period to the next period, it is able to be explained that the factors involved in the production process affect economic growth (Boediono, 1985). According to Sukirno (2008), included in the factors of production are land, labor, capital, and expertise.

The economic growth that occurs certainly cannot be separated from the role of the government. This role can be seen in the various policies taken by the government in the context of economic development. Fiscal policy is one of the policies carried out in order to maintain economic stability. Government spending is one of the government's fiscal policies to regulate the course of the economy by determining the amount of government revenue and spending each year.

In addition to government spending, in Keynes's theory, investment is one of the main indicators that can increase economic growth. One of the government's efforts to support economic development is through policymaking that supports investment that is mutually beneficial for the government, the private sector, and the community. Investment activities will continue to increase capital stock; increasing capital stock can increase productivity and production capacity and quality, resulting in the ability of investment to encourage economic growth (Sulistiawati, 2012). Based on Robert Solow's theory in Jufrida et al. (2016), capital formation and population growth are factors that have a significant influence on a country's economic growth.

As a developing country that has the potential to become a developed country, Indonesia needs some capital to carry out economic development efforts. The charm of natural resources in Indonesia is one of Indonesia's ways to attract investors to invest in Indonesia. However, it is not easy to attract investors to invest in Indonesia if it is not accompanied by various other factors that can hinder investors from investing in Indonesia, such as regulations, investment management, etc.

According to Todaro in Sulistiawati (2012), investment has an important role in changing the nation's economic life, because capital formation increases production capacity, increases national income, and creates new jobs; in this case, it will further expand employment opportunities. Furthermore, Mankiw states in Sulistiawati (2012) that technological innovation is one of the factors that can increase investment demand. According to Sukirno in Sulistiawati (2012), investment is defined as spending or investing in capital or companies to buy capital goods and equipment to increase the ability to produce goods and services available in the economy.

As for the relationship between investment and economic growth, according to Kuncoro in Sulistiawati (2012), economic growth also depends on the amount of investment value that is considered capable of driving the economy. Sulistiawati (2012) concluded that investment has a significant negative effect on economic growth. What is interesting in this study is that the research results are inversely proportional to several previous studies and existing theories, one of which is Keynesian theory, which states that investment is one of the factors that influence economic growth. This explains that, in fact, investment has not been able to increase economic growth in Indonesia. This is due to several factors inhibiting investment in Indonesia, such as low human resources and a lack of existing facilities.

In addition to government spending and investment that can boost the economy in Indonesia, the banking system, through financing policies provided to the economic sector, is a support for economic growth. The banking system, through the financing policies provided, has the same characteristics as government spending, especially in its ability to increase the demand side so as to encourage an increase in national income or output (Terminanto & Rama, 2017). In addition to investment in the form of PMDN and PMA, Islamic bank financing is also a form of investment channeled directly to the economic sector by Islamic banks.

According to Hilman et al. (2003) in Nofinawati (2016), the prospects for Islamic banking in Indonesia are experiencing increasingly bright growth. Islamic banking is a new type of industry that has high attractiveness. The Islamic banking system offers financial and banking products and services that are relatively the same as

conventional systems, but they operate in accordance with sharia provisions, especially in transactions that do not contain elements of usury, maysir, and gharar (Rama & Kassim, 2013).

Regarding the relationship between Islamic bank financing and economic growth, Hasyim (2016) shows that third party funds and financing provided by Islamic banks have a positive effect on economic growth. The results show that the research results are in harmony with one of Schumpeter's theoretical hypotheses that the Islamic banking sector encourages economic growth in the real sector in Indonesia. The research conducted by Putra in 2018 concluded that third party funds had a negative and insignificant effect on economic growth, while the variables of total assets, Islamic banking financing, conventional credit, and the value of regional expenditure revenues were significant for economic growth.

LITERATURE REVIEW

Economic Growth

According to Sukirno in Putra (2018), economic growth is defined as the development of activities in the economy that are able to increase the goods and services produced in society. Economic growth is one indicator of the success of a country's development. According to Prasetyo (2009) in Zahari MS (2017), economic growth simply means an increase in output or an increase in aggregate national income within a certain period of time, for example one year. A country is said to have experienced growth if the amount of real compensation for the use of factors of production in a given year was greater than in previous years.

Economic growth is the most important factor in the development of a country. The success of the development of a country or region is measured based on the level of economic growth that has been achieved. Economic growth is typically measured using the percentage increase in gross domestic product for the national and regional gross domestic product for provinces and districts/cities (Zahari MS, 2017).

In Islam, economic growth is defined as continuous production and yield growth in the right direction that can benefit all people, according to Sadeq (1989) and Abidin (2012). The fundamental difference between the views of conventional economics and the views of Islamic sciences regarding economic growth lies in the ultimate goal of economic growth. In the conventional economic view, economic growth is only oriented towards high growth because of the existence of economic activities without an even distribution of the output results obtained. Meanwhile, according to Islamic economics, economic growth is a means for society's welfare regardless of race, religion, or nation (Abidin, 2012).

Islamic Bank Financing and Economic Growth

According to Sharia Banking Law No. 21 of 2008 concerning banking, Islamic Banks are banks that run their business based on sharia principles, which, according to their type, consist of Islamic Commercial Banks and Islamic People's Financing Banks.

According to Mahliza (2011) in Susilo & Ratnawati (2015), Islamic bank financing is an alternative solution for business actors who have problems in terms of capital. Sharia financing will also have an important role for business actors in Indonesia in the future, especially for microbusiness actors. This important role is to be able to open up financing opportunities for business activities based on partnership principles. The development of micro-enterprises in Indonesia will have an impact on reducing unemployment, which will then have an impact on increasing people's income in Indonesia.

Sharia financing, according to Law Number 10 of 1998, is the provision of money or claims based on an agreement or agreement between the bank and another party requiring the party being financed to return the money or bill after a certain predetermined period of time in exchange for profit sharing.

Expenditures and Economic Growth

Keynesian theory assumes that government intervention in the economy can determine the optimal course of economic development. The implication of Keynes's view is that to ensure stable growth, the role of government is needed in managing the economy both through monetary policy (interest rates and money supply) and fiscal policy (taxation and government spending).

According to Keynes (1936), the macroeconomic situation of an economy is determined by what happens to people's aggregate demand. If aggregate demand exceeds aggregate supply (or the resulting output) in that period, a situation of "underproduction" will occur. In the next period, output will rise, prices will rise, or both will occur at once. If aggregate demand is less than aggregate supply, an overproduction situation occurs. In the following period, output, prices, or both will fall at the same time.

Aggregate demand is the entire amount of money spent by all levels of society to buy goods and services in one year. In a closed economy, aggregate demand consists of three elements: consumption spending by households (C), investment spending by firms (I), and government spending (G). The government can influence aggregate demand directly through government spending and indirectly through consumption and investment spending if it is formulated as follows: Z = C + I + G.

Each element of aggregate demand is affected by different factors. Consumption expenditure depends on the income received by the household and its propensity to consume. Investment expenditure is determined by the expected profit (marginal efficiency of capital) and the cost of funds (interest rate). Government spending is determined by complex political processes and, in macroeconomic theory, is considered exogenous.

Investment and Economic Growth

According to Keynes in Sulistiawati (2012) emphasized the importance of aggregate demand as the main factor that can drive the economy, in which both the state and the private sector play an important role. Keynes saw the government as an independent agent that was considered capable of stimulating the economy through public work. Expansionary government policies can increase "effective demand" if resources are used without harming consumption or investment.

According to Harrod-Domar in Sulistiawati (2012), who developed Keynesian theory related to the role of investment in the process of economic growth, particularly in its dual nature, First, investment is able to create income as a result of investment demand. Second, investment can increase the production capacity of the economy as a result of investment supply. According to Solow and Swan in Sulistiawati (2012), who corrected Harrod-Domar's theory by showing that economic growth depends on the availability of production factors (population, labor, and capital accumulation) and the level of technological progress.

According to Todaro in Sulistiawati (2012), investment plays an important role in driving the nation's economic life, with the assumption that capital formation will increase production capacity, increase national income, and create new jobs; in this case, it will further expand employment opportunities. Meanwhile, according to Mankiw in Sulistiawati (2012), technological innovation is one of the factors that can increase investment demand. Samuel-son stated that the rise and fall of national income is due to changes in investment, which in turn depend on changes in technology, interest rate declines, population growth, and other dynamic factors. According to Harrod-Domar, a development will be successful and well implemented if economic growth is determined by high capital and investment.

To achieve economic growth, high investment is required, but high capital requirements cannot only rely on low domestic capital formation. Therefore, foreign investment is needed to increase economic growth in Indonesia. In terms of capital formation, the role of both domestic and foreign investment contributes to economic growth.

RESEARCH METHOD

In this study, the authors used secondary data, namely, data sourced from various information media or obtained indirectly. This data is obtained in the form of evidence, records, or history that has been compiled in published documentary archives (Indrianto and Supomo, 2002). Based on the form of the data in this study, which is time series data that describes economic fluctuations and presents fiscal and banking policies, the impact of these policies on developments in the real sector does not have an immediate impact, which usually requires a certain period of time (lag). These three problems can be answered by the vector autoregressive model (VAR) and the vector error correction model (VECM). VAR/VECM is a type of macro-econometrics

model that is commonly used to analyze economic fluctuations. In addition, researchers also have reasons for using this method, namely because of several advantages of this method. According to Gujarati (2004) in Basuki (2018), there are several advantages of using VAR/VECM compared to other methods, including that it is simpler because there is no need to separate independent and dependent variables and that it uses simple estimation because it uses the usual OLS (Ordinary Least Square) method. The estimation results are better than those of other, more complicated methods (Basuki, 2018).

CASE STUDIES

Based on the results of the root test at the level, it can be seen that the data output on the stationarity test at the level shows that all variables have an ADF value greater than McKinnon's critical value of 5%, indicating that only the gross domestic product variable is stationary while the other variables are not, so the unit root test at the first difference must be performed. Based on the root test at the first difference level, the result is that only the financing variable is stationary, while the others are not because the ADF value is greater than the McKinnon critical value. From here, it is necessary to test the unit root at the second difference level. Based on the results of the unit root test at the second difference level, the result is that all variables are stationary because the ADF value is smaller than the McKinnon critical value.

The optimal lag length test is used to eliminate autocorrelation problems in the VAR system. The use of optimal lag with the aim of solving problems related to autocorrelation does not reappear. The optimal number of lags in this study is based on the smallest or minimum Akaike Information Criteria (AIC) and Schwarz Information Criterion (SIC) values. Based on the results of the lag test, it can be seen that the suggested lag in this study is the fifth lag.

Cointegration test to obtain a stable long-term equation in this analysis, the cointegration test is used to see whether the VECM method can be used or not. The VECM method can be used in the analysis if there are more than zero cointegration ranks. The cointegration test used is based on the Johansen cointegration test, with trace statistics used to determine the number of cointegrated equations in the system. The H1 hypothesis, which states that the number of cointegration ranks can be accepted if the trace statistic value is greater than the critical value at that level, is accepted. Based on the cointegration test results, it shows that there are 3 cointegrated equations. This can be seen because the value of the trace statistic and Max-Eigen statistic is greater than the critical value of five percent. Then all variables can be said to be cointegrated. The model to be used is the Vector Error Correction Model (VECM) because there are cointegrated equations.

Based on the VECM estimation results, it shows that in the short term the fourth lag GDP variable has a significant effect on GDP; this proves that GDP is affected by the previous lag, namely the fourth lag of GDP itself. Meanwhile, the variables of Islamic bank financing, government spending, and investment have no significant effect on economic growth in Indonesia. This proves that the independent variables in this study need time to influence GDP in Indonesia. Meanwhile, in the long term, Islamic bank financing, government spending, and investment have a significant effect on economic growth in Indonesia with different coefficient values.

Based on the results of the IRF test, it shows that the GDP response to shocks (changes) in the value of Islamic bank financing and investment variables tends to fluctuate up and down. Islamic bank financing shows a negative trend, which means that in the short and long term, shocks or declines in Islamic bank financing will be responded to in the same magnitude, and Islamic banking must be more careful in managing its financing funds. Government spending responds positively to economic growth, meaning that in the short and long term, shocks or increases in government spending will be responded to in the same manner. This shows that government spending that has been budgeted for economic development in Indonesia has made a positive contribution to economic growth in Indonesia. For investment, it tends to respond negatively to economic growth, meaning that in the short and long term, shocks or a decrease in investment will be responded to with the same magnitude. This condition was caused by investment growing unevenly and mostly in urban areas. So, there is a need for certainty or legal provisions in each region or province to build the investment or investment sector for their respective regions.

From the results of the Variance Decomposition (VD) test, in the first period, the gross domestic product was influenced by the gross domestic product itself. However, as the period goes on, other variables begin to influence it, although the magnitude is not as great as the influence of the gross domestic product itself. Government expenditure is the second largest variable after the variable gross domestic product. The initial period of its influence is 0.147441 and continues to increase until the end of the period of 15.11864. After the government spending variable, the third biggest influence is the Islamic bank financing variable of 0.148887 at the beginning of the period and 14.76147 at the end of the period, followed by an investment of 0.248205 at the beginning of the period and 2.784289 at the end of the period.

The results of this study indicate that, in the long term, Islamic bank financing has a significant and negative effect on economic growth. This shows that in the long term, changes in Islamic bank financing will always be followed by changes in GDP in the reverse direction, meaning that if there is an increase of 1% in GDP, there will be a decrease in Islamic bank financing.

The results of the VECM estimation test show that government spending has a positive and significant influence on economic growth in Indonesia. This can be seen from the value of the government expenditure coefficient of 1.446906 with a t-count value of 1.446906, meaning that every 1% increase in government expenditure will increase 1.45% of economic growth in Indonesia. The results of this study are the same as the results of Jamili's research (2017), which found that government spending has a significant positive influence on Indonesia's economic growth. This can be seen from the coefficient of 5.586348 with a probability value of 0.0000, meaning that every 1% increase in government spending will increase Indonesia's economic growth by 0.50% and vice versa.

Based on the results of the IRF (Impulse Response Function) test, Islamic bank financing shows a negative trend, which means that in the short and long term, shocks or declines in Islamic bank financing will be responded to in the same amount, and Islamic banking must be more careful in managing its financing funds.

Government spending responds positively to economic growth, meaning that in the short and long term, shocks or increases in government spending will be responded to in the same manner. This shows that government spending that has been budgeted for economic development in Indonesia has made a positive contribution to economic growth in Indonesia.

For investment, it tends to respond negatively to economic growth, meaning that in the short and long term, shocks or a decrease in investment will be responded to with the same magnitude. This condition was caused by investment growing unevenly and mostly in urban areas. So, there is a need for certainty or legal provisions in each region or province to build the investment or investment sector for their respective regions.

CONCLUSION

Based on the research that has been conducted with the aim of gathering empirical evidence regarding the influence of Islamic bank financing, government spending, and investment on Indonesia's economic growth from 2003 to 2019, by using time series data with the vector error correction model (VECM), the following conclusions are obtained, in the short term, Islamic bank financing does not have a significant effect on economic growth in Indonesia. whereas, in the long term, Islamic bank financing has a significant and negative effect on economic growth with a coefficient value of -1.111488. This shows that in the long term, changes in Islamic bank financing will always be followed by changes in GDP in the reverse direction, meaning that if there is an increase of 1% in GDP, there will be a decrease of 1.11% in Islamic bank financing. In the short term, government spending has no significant effect on economic growth in Indonesia. whereas in the long run, government spending has a positive and significant influence on economic growth in Indonesia. This can be seen from the value of the government expenditure coefficient of 1.446906 with a t-count value of 1.446906, meaning that every 1% increase in government expenditure will increase 1.45% of economic growth in Indonesia. In the short term, investment has no significant effect on economic growth in Indonesia. Whereas in the long term, investment has a significant and negative effect on economic growth in Indonesia with a coefficient value of -0.215974, meaning that every 1% increase in investment causes a decrease in economic growth of 0.22% or

vice versa. This condition is caused by the global economic crisis, the unfavorable investment climatehereas in the long term, investment has a significant and negative effect on economic growth in Indonesia with a coefficient value of -0.215974, meaning that every 1% increase in investment causes a decrease in economic growth of 0.22% or vice versa. This condition is caused by the global economic crisis, the unfavorable investment climate, and the uneven spread of investment in Indonesia. This climate can be caused by the low level of public services and the lack of legal certainty. The low level of public services is due to the lengthy time for licensing and bureaucracy, and there are still illegal fees.

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