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# DETERMINANTS OF ECONOMIC GROWTH IN INDONESIA IN THE SHORT AND LONG TERM: AN ANALYSIS OF THE ISLAMIC HUMAN DEVELOPMENT INDEX (I-HDI), EXTERNAL DEBT, INVESTMENT, EXCHANGE RATES AND GOVERNMENT EXPENDITURE

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## Abstract

Indonesia's economic growth continues to fluctuate in line with the dynamics of national development and global economic pressures. Indonesia's economic growth is inextricably linked to various interrelated factors, both from a macroeconomic perspective and in terms of the quality of human development. This study therefore aims to analyse the determinants of economic growth in Indonesia in both the short and long term, using independent variables comprising the I-HDI, external debt, investment, the exchange rate and government expenditure for the period 1996–2025. This study employs a quantitative method with an associative research design. The sampling technique used in this study is non-probability sampling, specifically total sampling. The sample comprised 30 data points, covering the period from 1996 to 2025, in the form of secondary time-series data. Data collection was carried out using the documentation technique. Data analysis was conducted using the Autoregressive Distributed Lag (ARDL) model with the assistance of EViews 13 software. The research findings indicate that the I-HDI has a positive and significant impact on economic growth in the long term, whilst in the short term the impact remains positive but is not yet significant. External debt has been shown to have a negative and significant impact on economic growth, in both the short and long term. Investment has a positive and significant impact in the long term, whilst in the short term the impact is positive but not

significant. The exchange rate has a negative and significant impact in the long term, whilst in the short term the impact is negative but not yet significant. Government expenditure, meanwhile, has a positive and significant impact on economic growth, both in the short and long term. These findings indicate that the I-HDI, investment and the exchange rate have not yet had a significant impact on economic growth in the short term. Consequently, policies and improvements in the quality of human development based on the maqashid syariah, the acceleration of productive investment, and exchange rate stability need to be strengthened so that their impact on economic growth can be felt more quickly. The Ministry of Finance can then strengthen fiscal management, whilst foreign debt should be channelled towards sectors with a high multiplier effect. Furthermore, Bank Indonesia continues to maintain the stability of the rupiah exchange rate and strengthen coordination of monetary policy. The Central Statistics Agency can also continue to improve the quality, completeness and timeliness of the economic and social statistical data required for the formulation of development policies. The Ministry of Finance can strengthen fiscal management and foreign debt management, which should be directed towards sectors with a high multiplier effect. Furthermore, Bank Indonesia continues to maintain the stability of the rupiah exchange rate and strengthen monetary policy coordination. The Central Statistics Agency can continue to improve the quality, completeness, and timeliness of the economic and social statistical data required for the formulation of development policies.

**Keywords:** Economic Growth, I-HDI, External Debt, Investment, Exchange Rate, Government Expenditure

## INTRODUCTION

In the Society 5.0 era, economic development is no longer solely oriented toward increasing output but is directed toward creating people and environment-centered prosperity while ensuring that its benefits are shared by all members of society (Langoday, 2024). Economic development is not only related to a country's ability to expand its production capacity but also to its success in improving human quality, expanding employment opportunities, maintaining economic stability, and strengthening social resilience. In practice, the development process often faces interconnected challenges, including limited capital, substantial financing needs, disparities in human resources, exchange rate pressures, and the effectiveness of fiscal policies (Langoday, 2024).

Economic growth is commonly used as an indicator to measure the achievement of economic development. It reflects the progress of economic activities, which is characterized by an increase in the production of goods and services over a given period. Economic growth is generally associated with changes in Gross Domestic Product (GDP) or Gross National Product (GNP), which represent a country's productive capacity (Marselino et.al., 2022). However, economic growth does not always remain stable. Changes in global conditions, health crises, inflationary pressures, exchange rate fluctuations, debt burdens, and shifts in fiscal policy can influence the direction of economic growth over time.

As a developing country, Indonesia has a substantial need to maintain strong and sustainable economic growth. A study by Sujianto and Mashudi (2024) shows that natural resource commodities, including crude oil, coal, and natural gas, are associated with

Indonesia's Gross Domestic Product (GDP), although their contributions are not consistently strong and continue to pose challenges to environmental sustainability (Sujianto & Mashudi, 2024). Indonesia's economic growth, for example, reached 7.8% in 1996, declined to 4.7% in 1997, and experienced a severe contraction of –13.1% in 1998 as a result of the Asian financial crisis.

Indonesia's economic growth contracted by 2.1% in 2020 during the COVID-19 pandemic and recovered to 3.7% in 2021. It further increased to 5.3% in 2022, before declining slightly to 5.0% in 2023 and remaining at the same level in 2024. Subsequently, economic growth rose to 5.1% in 2025. This trend indicates that Indonesia's economy has gradually transitioned from the recovery phase to a more stable growth phase, although the pace of growth has remained relatively moderate. A study by Asiyah et al. (2024) explains that the COVID-19 pandemic temporarily slowed the national economy; however, Islamic financial instruments can play a significant role in supporting the recovery of economic activities (Asiyah et al., 2024).

One of the indicators used to measure human development from an Islamic perspective is the Islamic Human Development Index (I-HDI). The I-HDI was developed because the Human Development Index (HDI) has not been able to fully capture the concept of human development in Muslim-majority countries. Rafsanjani (2018) argued that although the HDI can be used as a measure of human development, it is not entirely compatible with assessing human development from an Islamic perspective (Rafsanjani, 2018). The I-HDI is founded on the theory and principles of *maqashid syariah*, encompassing five essential dimensions: the preservation of religion, life, intellect, lineage, and wealth.

In addition to the Islamic Human Development Index (I-HDI), external debt is another important variable in explaining Indonesia's economic growth. Developing countries often face limited domestic savings and substantial financing needs to support development. Under such circumstances, external debt is regarded as an important source of financing to bridge capital shortages, accelerate infrastructure development, finance budget deficits, and support economic activities. The Harrod–Domar Theory and the Two-Gap Model provide a theoretical basis for external financing, arguing that developing countries frequently experience savings and investment gaps that can be addressed through foreign capital inflows (Sukirno,2008).

The increase in external debt creates a dilemma for Indonesia's economic development. On the one hand, external debt can serve as a source of financing that promotes investment, infrastructure development, and the expansion of productive capacity. On the other hand, an increase in external debt that is not accompanied by productive utilization may lead to higher principal and interest repayment burdens, reduce fiscal space, and increase vulnerability to fluctuations in exchange rates and global interest rates.

Previous studies have reported mixed findings regarding the relationship between external debt and economic growth. For instance, Sari (2022) found that external debt has a negative effect on Gross Domestic Product (GDP) in both the short and long run (Sari, 2022). In contrast, Asnawi (2022) reported that, in the long run, external debt has a positive and significant effect on economic growth (Asnawi, 2022). These inconsistent findings suggest that the impact of external debt depends on several factors, including the composition of debt, its intended use, the productivity of borrowed funds, fiscal conditions, and macroeconomic

stability. Therefore, external debt remains a relevant variable to be examined in this study by distinguishing its short-run and long-run effects.

Increased investment can expand industrial capacity, enhance productivity, and create new employment opportunities. However, the impact of investment on economic growth does not always materialize within the same period. Investment requires time to be realized, beginning with licensing procedures, the construction of production facilities, workforce recruitment, and ultimately the generation of economic output. According to World Bank data, Indonesia's investment amounted to US$67.31 billion in 1996, declined to US$61.07 billion in 1997, and fell sharply to US$24.27 billion in 1998 as a result of the Asian financial crisis, which undermined investor confidence and worsened the national investment climate.

Previous studies have also reported mixed findings regarding the impact of investment on economic growth. For example, Muyambiri and Mabejane (2023) found a bidirectional causal relationship between investment and economic growth in Botswana in both the short and long run (Muyambiri & Mabejane, 2023). Similarly, Meilisa et al. (2024) demonstrated the multifaceted effects of foreign direct investment (FDI) on Indonesia's economic growth, indicating that FDI contributes positively to economic performance in both the short and long run (Meilisa et al., 2024). In contrast, Mawutor et al. (2023) reported that foreign direct investment has a negative and significant effect on Ghana's economic growth in both the short and long run (Mawutor et al., 2023). These contrasting findings suggest that the effect of investment on economic growth may vary across countries depending on economic structure, institutional quality, macroeconomic conditions, and the effectiveness of investment allocation.

The depreciation of the Indonesian rupiah can have varying effects on the economy. On the one hand, a weaker rupiah may enhance export competitiveness by making domestically produced goods relatively less expensive in international markets. On the other hand, rupiah depreciation can increase the cost of importing raw materials and capital goods, contribute to inflationary pressures, and raise the burden of servicing external debt denominated in foreign currencies. Exchange rate depreciation is therefore a critical issue for Indonesia, given its continued reliance on imported raw materials and external financing.

During the COVID-19 pandemic, government expenditure increased to US$102.26 billion in 2020 and further rose to US$109.72 billion in 2021 in response to the need for healthcare financing, social assistance, and the National Economic Recovery (PEN) Program. Although government expenditure declined slightly in 2022, it increased again in 2023 to US$102.21 billion and continued to rise, reaching US$110.52 billion in 2025.

However, the increase in government expenditure has not been fully accompanied by higher and more stable economic growth. Throughout the 2013–2025 period, Indonesia's economic growth remained relatively stable at around 5%, despite the continuous increase in government spending. The effectiveness of government expenditure largely depends on the quality of budget allocation and the government's ability to direct spending toward productive sectors with high multiplier effects, such as infrastructure, education, healthcare, and social protection.

The novelty of this study lies in the integration of Islamic human development and macroeconomic variables into a single analytical framework for examining Indonesia's economic growth. The Islamic Human Development Index (I-HDI) is incorporated to provide an Islamic economic perspective and to extend the measurement of human development

beyond the conventional Human Development Index (HDI). Meanwhile, external debt, investment, exchange rates, and government expenditure are selected because they represent key dimensions of development financing, capital accumulation, external stability, and fiscal policy, respectively. Furthermore, this study employs both short-run and long-run estimations, as the effects of each variable on economic growth may not occur simultaneously but may emerge over different time horizons.

Based on the research paradigm described above, this study is designed to further analyze the determinants of economic growth in Indonesia under the title: "Determinants of Economic Growth in Indonesia in the Short Run and Long Run: An Analysis of the Islamic Human Development Index (I-HDI), External Debt, Investment, Exchange Rate, and Government Expenditure".

## REVIEW OF LITERATURE

### Classical Growth Theory

Classical economic growth theory is generally divided into three main perspectives: those of Adam Smith, David Ricardo, and Thomas Robert Malthus. According to Adam Smith, there is a direct relationship between economic growth and the performance of specific industries. Economic growth is driven by capital accumulation, technological progress, the division of labor, specialization, and market expansion, all of which contribute to improved industrial performance.

### Neoclassical Growth Theory

The Neoclassical Growth Theory was pioneered by Robert Solow and Trevor Swan and has developed since the 1950s. This theory argues that economic growth is strongly influenced by increases in the factors of production, including population, labor, capital, and technological progress.

### Economic Growth

Economic growth refers to an increase in national income over a given period and reflects an expansion in the economy's capacity to produce goods and services (Rapanna & Sukarno, 2017). Economic growth can also be defined as a continuous process of change toward improved economic conditions within a country's economy (Tampubolon et al., 2025)

### Islamic Human Development Index (I-HDI)

The Human Development Index (HDI), introduced by the United Nations Development Programme (UNDP) as a tool for measuring human development, is arguably one of the most comprehensive indicators available. However, the existing HDI framework is value-neutral and does not capture the religious perspective or the ethical dimensions of socio-economic development in Muslim countries.

### External Debt

According to Todaro and Smith, external debt refers to the total amount of official loans, whether in the form of financial resources or other assets, obtained from foreign sources. In developing countries, these funds are utilized to support income distribution and finance economic development (Todaro & Smith, 2021).

### Investment

Investment refers to expenditure undertaken to increase a country's productive capacity, either through physical assets (such as buildings, machinery, and equipment) or non-physical assets (such as research and development). In macroeconomics, investment is

a key component in the formation of Gross Domestic Product (GDP). It is defined as the expenditure or capital outlay made by firms to acquire capital goods and production equipment in order to expand their capacity to produce goods and services (Suparmono, 2018).

**Exchange Rate**

The exchange rate can be defined as the price of one country's currency expressed in terms of another country's currency. In international finance, exchange rates play a crucial role because cross-border transactions involve the use of different currencies.

**Government Expenditure**

Government expenditure is one of the fiscal policy instruments used by the state to finance government operations, the provision of public goods and services, infrastructure development, and social programs.

## RESEARCH METHOD

This study employs a quantitative approach and adopts an associative research design, which aims to examine the relationships among two or more variables. Furthermore, the study utilizes time-series analysis to investigate the short-run and long-run effects of the independent variables, the Islamic Human Development Index (I-HDI), external debt, investment, exchange rate, and government expenditure on the dependent variable, economic growth. The population of this study consists of annual data on the I-HDI, external debt, investment, exchange rate, government expenditure, and economic growth in Indonesia from 1996 to 2025, resulting in 30 observations for each variable. The sampling technique employed is non-probability sampling, specifically total sampling, whereby all observations within the study period are included as the sample. Accordingly, the sample comprises annual data for the I-HDI, external debt, investment, exchange rate, government expenditure, and economic growth in Indonesia from 1996–2025, with 30 observations for each variable. This study relies exclusively on secondary data, which are obtained from previously collected and publicly available sources rather than directly from primary respondents. The data were collected from the official websites of the World Bank, Statistics Indonesia (BPS), Transparency International, Macrotrends, Worldometer, Our World in Data, and the International Monetary Fund (IMF). Data were collected using the documentation method, and the data were analyzed using the Autoregressive Distributed Lag (ARDL) model.

## RESULTS AND DISCUSSION

**Table 1.**
**t-test**

| Variabel | Coefisien | Probability | Decision |
|---|---|---|---|
| **X1** | 2,090263 | 0,1942 | Not Significant |
| **X2** | -0,249716 | 0,0001 | Significant |
| **X3** | 4,300506 | 2,7778 | Not Significant |
| **X4** | -2,306211 | 0,0945 | Not Significant |
| **X5** | 2,533320 | 0,0254 | Significant |

The Islamic Human Development Index (I-HDI) has a positive but insignificant effect on economic growth in Indonesia in the short run. This is indicated by the coefficient value of 2.090263, which is positive, and a probability value of 0.1942, exceeding the 5% significance level. Therefore, it can be concluded that a one-unit increase in the I-HDI is associated with an insignificant increase of 2.090263 units in Indonesia's economic growth. This finding is due to the fact that the al-maal dimension is not yet fully established, as its highest index stood at only 40.3 in 2003, falling to 20.9 in 2011 and 19.4 in 2013, before rising to 34.8 in 2025. The al-maal index remains low and has not yet reached its optimal level, whilst also remaining somewhat volatile. Furthermore, the ad-dien dimension, as proxied by the CPI, also remains volatile and has not yet reached its optimal level of 40, recorded in 2019. In 2025, the ad-dien index still stands at 34, indicating a low level and a lack of strength in driving economic activity. In line with the theory put forward by Robert Solow and Trevor Swan, which states that economic growth is heavily influenced by increases in the supply of factors of production such as population, labour, capital and technological progress.

External debt has a negative and statistically significant effect on economic growth in Indonesia in the short run. This is indicated by the coefficient value of −0.249716, which is negative, and a probability value of 0.0001, which is lower than the 5% significance level. Therefore, it can be concluded that a one-unit increase in external debt is associated with a 0.249716-unit decrease in Indonesia's economic growth. It is evident that Indonesia's external debt has risen from around US$144B in 2000 to around US$421B in 2024. This increase indicates that external financing remains a vital component of the Indonesian economy, but at the same time it also adds to future repayment obligations. Pressure is mounting as the rupiah has also weakened, from Rp8,421.775 per US dollar in 2000 to Rp15,855.45 per US dollar in 2024. In line with the Harrod-Domar growth theory, this highlights the use of foreign aid to finance development.

Investment has a positive but statistically insignificant effect on economic growth in Indonesia in the short run. This is indicated by the positive coefficient value of 4.300506 and a probability value of 2.7778, which is greater than the 5% significance level. Therefore, it can be concluded that a one-unit increase in investment is associated with an insignificant increase of 4.300506 units in Indonesia's economic growth. As was the case in 2024, Indonesia's realised investment did indeed reach Rp1,714.2 trillion and created 2,456,130 jobs; however, the impact of investment on economic output is not always immediately apparent in the short term, as some investment flows into sectors that require longer development and production processes. This is evident from the significant role played by downstream processing, which in the third quarter of 2024 accounted for Rp91.51 trillion, or 21.2 per cent, of the total investment realised in that quarter. Investment in the downstream sector, basic metals, transport, warehousing, telecommunications, mining and the chemical industry requires time to build production facilities, develop technology, strengthen supply chains and generate added value. In line with endogenous growth theory, Paul Romer's growth model posits that knowledge capital factors such as innovation, research, development and investment in education can act as drivers of long-term economic growth.

The exchange rate has a negative but statistically insignificant effect on economic growth in Indonesia in the short run. This is indicated by the negative coefficient value of −2.306211 and a probability value of 0.0945, which is greater than the 5% significance level.

Therefore, it can be concluded that a one-unit increase in the exchange rate is associated with an insignificant decrease of 2.306211 units in Indonesia's economic growth. In line with Indonesia's economic structure, in 2024, Indonesia's imports were dominated by raw materials, accounting for 72.58 per cent of total imports, whilst capital goods accounted for 17.75 per cent. Furthermore, in 2024, the rupiah weakened by 4.34 per cent on a point-to-point basis and by 3.74 per cent on average compared with 2023, meaning that exchange rate pressures remain a factor to be taken into account. In line with the Mundell–Fleming theory, which describes a small open economy with perfect capital mobility, domestic interest rates follow global interest rates.

Government expenditure has a positive and statistically significant effect on economic growth in Indonesia in the short run. This is indicated by the positive coefficient value of 2.533320 and a probability value of 0.0254, which is lower than the 5% significance level. Therefore, it can be concluded that a one-unit increase in government expenditure leads to an increase of 2.533320 units in Indonesia's economic growth. Similarly, in 2024, when Indonesia's economy grew by 5.03 per cent, the government expenditure component recorded the highest growth in terms of expenditure during the fourth quarter of 2024, at 38.58 per cent quarter-on-quarter. Furthermore, actual government expenditure by the end of October 2024 reached Rp2,556.72 trillion, representing a year-on-year growth of 14.10 per cent, driven, amongst other factors, by expenditure on stabilising food supply and prices, the conduct of general elections, social assistance, energy subsidies, non-energy subsidies, and transfers to the regions. This is in line with classical economic growth theory, which is divided into three schools of thought: those of Adam Smith, David Ricardo and Robert Malthus. Adam Smith's theory posits that there is a direct correlation between economic growth and the performance of specific industries. Capital accumulation, technological progress, the division of labour, specialisation and market expansion will all benefit from improved departmental performance. In David Ricardo's theory of growth, the central theme of the economic growth process remains the interplay between the rate of population growth and the rate of output growth. Meanwhile, according to Robert Malthus's theory of growth, the population will grow faster than the economy, resulting in labour wages becoming extremely low and sufficient only to cover daily living costs.

## CONCLUSION

Based on the discussion of the research findings regarding the Determinants of Economic Growth in Indonesia in the Short Run and Long Run: An Analysis of the Islamic Human Development Index (I-HDI), External Debt, Investment, Exchange Rate, and Government Expenditure, the following conclusions can be drawn:

1. Based on the findings, it can be concluded that, in the long run, the Islamic Human Development Index (I-HDI) has a positive and statistically significant effect on economic growth. This indicates that improvements in the quality of human development based on the principles of maqashid shariah can significantly promote economic growth. In contrast, in the short run, the I-HDI also exhibits a positive relationship with economic growth; however, the effect is not statistically significant because the impact of human development cannot be observed immediately over a short period. These findings support the view that economic growth is determined not only by

physical capital, labor, and technological progress, but also by the quality of human development, encompassing the dimensions of religion, life, intellect, lineage, and wealth.

2. Based on the findings, it can be concluded that external debt has a negative and statistically significant effect on Indonesia's economic growth in both the short run and long run. This means that an increase in external debt tends to reduce economic growth, while a reduction in the external debt burden can provide greater opportunities for improving economic growth. Therefore, external debt does not always serve as a solution to overcome limitations in development financing, as its effectiveness largely depends on debt management, fund allocation, the productivity of fund utilization, and the country's ability to repay its obligations.
3. Based on the findings, it can be concluded that investment has a positive effect on Indonesia's economic growth, although the magnitude of the effect differs between the long run and the short run. Investment requires time to be transformed into production activities, income generation, and higher economic output. Therefore, investment should be directed toward productive sectors that have broad impacts on the economy, such as industry, infrastructure, technology, education, and the real sector. Investment can serve as one of the main drivers of stronger, more sustainable economic growth in Indonesia and reduce dependence on short-term consumption.
4. Based on the findings, it can be concluded that the exchange rate has a negative effect on Indonesia's economic growth, although the level of significance differs between the long run and the short run. A decrease in the exchange rate, which reflects the appreciation of the rupiah against foreign currencies, can encourage economic growth, and vice versa. Furthermore, exchange rate fluctuations are not always immediately reflected in economic output. Therefore, exchange rate stability needs to be maintained as part of Indonesia’s strategy to sustain economic growth, particularly through strengthening foreign exchange reserves, controlling inflation, increasing exports, reducing import dependency, and managing capital flows
5. Based on the findings, it can be concluded that government expenditure has a positive and statistically significant effect on Indonesia's economic growth in both the short run and long run. This means that an increase in government expenditure can promote economic growth, both through its direct effect on aggregate demand and its long-term effect on national production capacity. However, the positive impact remains dependent on the government's ability to allocate spending toward sectors that generate a high multiplier effect on the national economy.

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