



What determines economic growth in the split province in Indonesia?

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Article history:

Received: September 27, 2024

1st Revision: October 30, 2024

Accepted: November 19, 2024

JEL classification:

O40

H50

H20

E21

E22

R11

DOI:

[10.14254/jems.2024.9-2.6](https://doi.org/10.14254/jems.2024.9-2.6)

Abstract: *Purpose:* This study aims to analyze the determinants of economic growth in split provinces of Indonesia, focusing on household consumption, investment, government spending, and taxes.

Methodology: The research employs panel data regression analysis using data from 25 split provinces in Indonesia from 2014-2022. The Fixed Effect Model (FEM) was determined as the best model through Chow and Hausman tests.

Results: The findings indicate that household consumption, investment, goods and services spending, and taxes have significant positive effects on economic growth in split provinces. Conversely, capital spending shows a significant adverse effect on economic growth.

Theoretical contribution: This study contributes to the literature on regional economic growth by providing empirical evidence on the determinants of economic growth, specifically in the context of split provinces in Indonesia. It highlights the differential impacts of various economic factors on newly formed administrative regions.

Practical implications: The results suggest local governments should focus on creating a conducive investment climate, optimizing tax collection, and carefully allocating spending to promote economic growth in split provinces. The negative effect of capital spending underscores the need for more effective and efficient use of these funds.

Keywords: consumption, investment, government spending, taxes, economic growth

Sustainable Development Goals (SDGs): SDG 8: Decent Work and Economic Growth

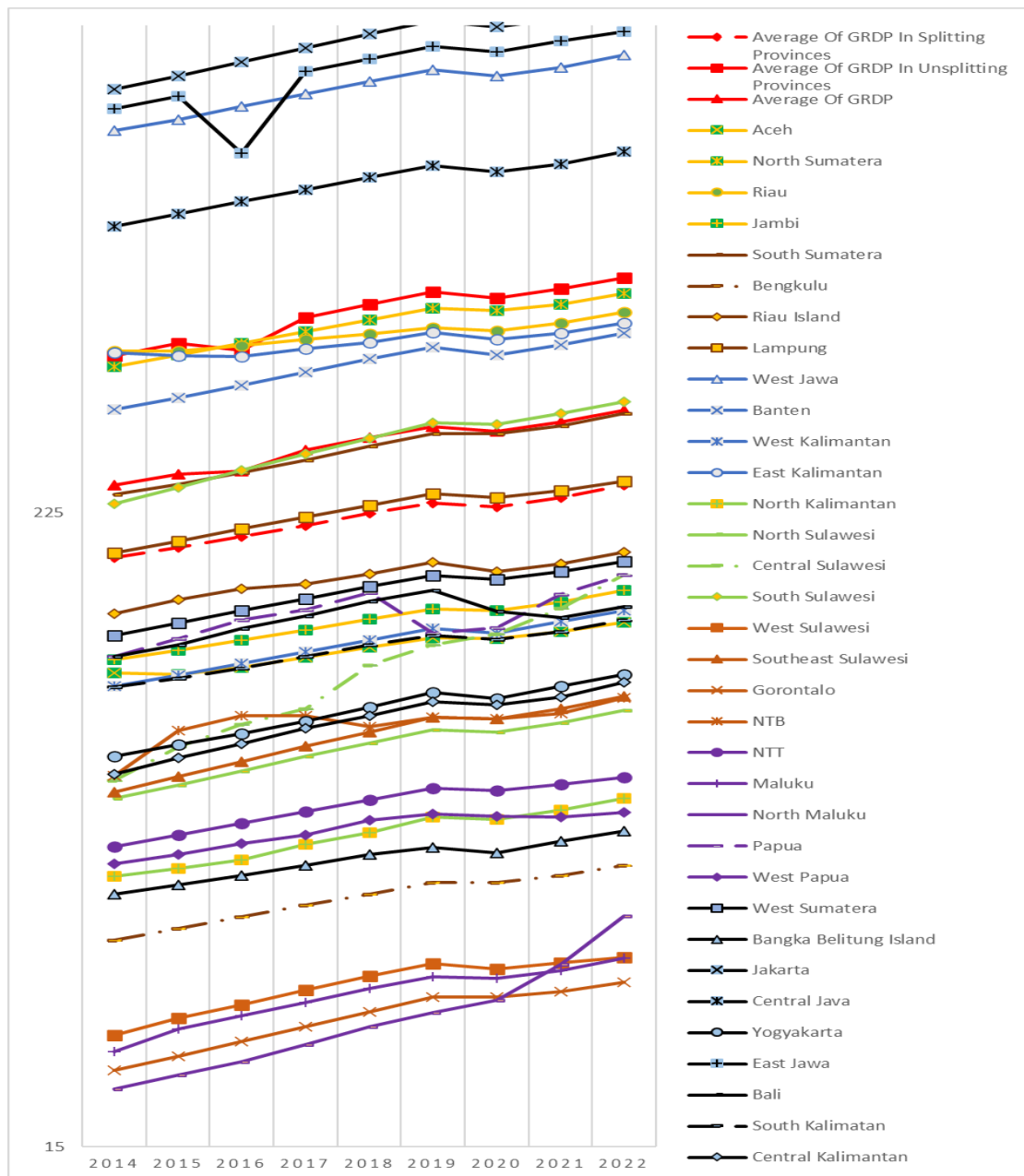


1. Introduction

Economic growth has always been a central topic discussed in developing countries. The goal of economic growth is to increase the prosperity of its people (Putra *et al.*, 2022). The government seeks to maximize economic growth in Indonesia through a split regional policy. One of the goals of the regional split is economic development planning in the region by utilizing local potential that has yet to be utilized so far (Maulia, 2023).

Economic growth indicates the government's success in implementing development, including regulating government funds. Economic growth is measured through income and expenditure over a certain period (Sudirman & Alhudori, 2018). One of the measures that explains the condition of economic growth in the region is the Gross Regional Domestic Product (GRDP). GRDP is the basis for calculating a region's economic growth, projected as national income (Y) in expenditure. The increase in output or aggregate national income over some time is called economic growth (Putra *et al.*, 2021; Lianda *et al.*, 2021; Pangestu, 2018; Etika *et al.*, 2022; Sadli *et al.*, 2022). For this reason, this study uses GRDP to look at regional economic growth in Indonesia. Graph 1 illustrates the GRDP in 34 provinces in Indonesia.

Figure 1: GRDP and average of GRDP in Indonesia (in IDR Billion)



Source: Central Statistics Agency

From Graph 1, 9 provinces with black lines are un-split, and the remaining 25 (lines other than black) are split provinces in Indonesia. The average GRDP of split provinces is lower than that of un-split provinces'. Only five of the 25 split provinces had an average GRDP or above: West Java, North Sumatra, Riau, East Kalimantan, and Banten. Meanwhile, South Sumatra and South Sulawesi (split provinces) have GRDP almost equal to the average GRDP of 34 provinces in Indonesia. This regional splitting aims to exploit various local economic development planning potentials. The lower average GRDP in split provinces indicates that the goal of regional splitting has yet to be achieved. Encouraging economic growth is still the main priority. Therefore, analyzing the factors determining economic growth in split provinces is necessary. It needs to be done to achieve the goal of region splitting. The regional economy will develop rapidly through high economic growth. For this reason, this study aims to analyze the determinants of economic growth in split provinces in Indonesia.

2. Literature review

Economic growth is the result of economic activities that will encourage an increase in people's income in a certain period in a region or country. Economic growth can be sourced from aggregate demand (AD) and/or the aggregate supply side (AS). In terms of aggregate demand, economic growth is driven by increased demand. Meanwhile, from the aspect of aggregate supply, economic growth is seen from the aspect of production. Various theories of economic growth have emerged during its development. In the view of classical theory, economic growth occurs by assuming the existence of a perfect competitive economy; through an "invisible hand," national output will be maximized. According to this view, capital accumulation is the basis for economic growth, so mobilizing savings to generate sufficient capital for investment will accelerate economic growth (Todaro & Smith, 2015). Another thing that classical thinkers have come up with is the "trickle-down" doctrine, which explains how the benefits of economic growth can affect all societies moderately.

Meanwhile, Keynes' theory states that national income (Y) in terms of expenditure consists of household sector expenditure in the form of household consumption of goods and services (C), investment (I), government expenditures (G), and foreign sector expenditure in the form of net exports (X-M), which is formulated with $Y = C + I + G + (X-M)$. For this reason, the first variable in Keynesian theory, namely consumption, explains that household consumption contributes to national income. Household consumption in Indonesia accounts for around 60-75 percent of national income (Permana, 2021). It also affects fluctuations in economic activity in the long term. It can increase economic growth if public consumption increases through increasing people's purchasing power. Household consumption is an indicator of economic driving activities with the buying and selling of goods and services to meet household needs based on the income owned by each community (Haniko *et al.*, 2022). So, stimulating the economy through the consumption side is an effective way for the Indonesian government because the more household consumption, the more demand for goods and services, and the more buying and selling activities accelerate the increase of economic activities and, finally, the increase in economic growth. Consumption is an element that needs to be considered in the economy because consumption can increase national income and affect economic fluctuations. Also, consumption is directly proportional to people's income (Sudirman & Alhudori, 2018). Several previous studies show that household consumption has a positive effect on economic growth, such as studies conducted by Al Rasasi *et al.* (2021), Paksi (2021), Haniko *et al.* (2022), Putra *et al.* (2021), Permana *et al.* (2021), Imawan (2021), Afifah *et al.* (2019), Almaya *et al.* (2021), Tondok *et al.* (2023). So, the first hypothesis is that household consumption positively affects economic growth.

Apart from the consumption side, increasing economic growth, according to Keynes, can be done through investment. The investment will contribute to economic growth in the short and long term. The investment will increase production capacity to increase output and value added to goods and services products, which will ultimately increase economic growth. So, investment and economic growth have a one-way influence; where the investment increases, economic growth will also increase, and vice versa. Attracting investors to invest in the split regions is one of the government's efforts to boost the regional economy.

Investment in the 25 split provinces has increased yearly; in 2020 and 2021, it still increased even though it did not increase too high like previous years due to the COVID-19 pandemic. However, from 2021 to 2022, investment has increased significantly. It shows that investment can boost the regional economy. The investment will increase industrial production capacity, create jobs, reduce unemployment, increase the output of goods and services, increase value added to national income, and increase economic growth (Regina, 2022). It is supported by research conducted by Pambudy & Ferdiansah (2022), Syairozi (2019), Sudirman & Alhudori (2018), Sadli *et al.* (2022), Safari & Fikri

(2016), Sari *et al.* (2016), Permana (2021), Mawati & Anitasari (2023). Based on the previous research, the second hypothesis is that investment positively affects economic growth.

Furthermore, according to Keynes' theory, finding the added value of national income can also be done through government spending. Maintaining stability and increasing economic growth can be done by stimulating the economy through government spending. Government expenditures are needed to finance economic activities to encourage annual economic growth. Therefore, government intervention through spending will encourage economic growth (Rambe & Ekaputri, 2021; Ogundipe & Oluwatobi, 2013; Abdullah *et al.*, 2017; Dinh Thanh *et al.*, 2020). Furthermore, a country's economic growth can be measured by how effective its government spending is (Putra *et al.*, 2022). Through goods and services spending and capital spending, for example. Procurement of goods and services is the procurement of goods within the scope of the government that is useful for the short term (less than one year of the accounting period). Goods and services spending is used to meet the needs of government employees in carrying out internal and external work to achieve maximum results (Ningsi *et al.*, 2023). So, goods and services spending can improve the economy if it is used to encourage the improvement of the quality of employee work in carrying out their duties. This study aligns with empirical studies showing that spending on goods and services positively affects economic growth (Hutarabat, 2013; Badrudin, 2012; Pusporini, 2020; Amri, 2020; and Ayu *et al.*, 2020). Thus, the third research hypothesis is that goods and services spending positively affects economic growth.

Not only goods and services spending but capital spending will also affect economic growth through the capital formation for assets or increasing capacity. Capital spending is government expenditure to obtain assets, whether fixed assets or others, that create benefits in the long term or more than one accounting period. The government uses capital spending to build facilities and infrastructure such as land, roads, buildings, and others that directly impact the community and are expected to boost the region's economy. The development carried out will have an impact on the region's economy. Capital spending has a positive influence on economic growth, which is in line with the studies of Ethics *et al.* (2022), Pambudy & Syaurozi (2019), Winarni *et al.* (2020), and Arlintang *et al.* (2020). However, capital spending needs to be used appropriately. In that case, it will have the opposite effect, as with research conducted by Arini (2016), Ayu *et al.* (2020), Maulia (2023), Digdowiseiso (2021), Panggabean (2014), Suherlan (2017), and Putra *et al.* (2021) which shows that capital spending has a negative influence on economic growth. Based on previous research, the fourth hypothesis is that capital spending positively affects economic growth.

Besides consumption, investment, and government spending mentioned in Keynes' theory, taxes also affect economic growth. Local revenue increases will encourage economic growth. Taxes mean a local government's ability to finance its activities. Taxes are government fiscal policy expected to suppress economic fluctuations, maintain the economy, and increase economic growth (Sadli *et al.*, 2022). Taxes as a source of government revenues are used to balance expenditure and revenue, regulate social and economic policies, stabilize the economy, and reduce regional development inequality (Rosi, 2022). Local taxes affect economic growth, if there is an increase in local taxes, economic growth will also increase (Orbaningsih & Sujianto, 2022; Rohima *et al.*, 2022; Alkasasbeh *et al.*, 2018; Ofoegbu *et al.*, 2016; Acosta-Ormaechea *et al.*, 2019; Lianda *et al.*, 2021; Dewi, 2018; Sumaryani, 2019; Sufardi, 2019; Yudiawati, 2012; and Rambe & Febriani, 2020). Therefore, the fifth research hypothesis is that taxes positively affect economic growth.

3. Research methods

This study uses an explanatory method to examine the influence of household consumption, investment, goods and services spending, capital spending, and taxes on economic growth in 25 split provinces in Indonesia from 2014 to 2022. Table 1 describes the definitions of the dependent and independent variables studied.

Table 1: Variable Description

Economic Growth	Gross Regional Domestic Product (GRDP) is based on constant prices in the split provinces.
Household Consumption	All expenditure on goods and services by household residents.
Investment	The realization of funds invested and used in development projects consists of domestic and foreign direct investment.
Goods and Services Spending	Government spending to purchase goods and services in the short term.
Capital spending	Chase government spending to purchase fixed assets, build infrastructures, and others (long-term usage).
Tax	Taxes are collected and used by the local government.

The data used is secondary data from Statistics Indonesia and the Finance Ministry of Indonesia. Data panel used consists of nine years (2014-2022) in 25 split provinces in Indonesia, namely Aceh, North Sumatra, Riau, Jambi, Bengkulu, Lampung, South Sumatra, Riau Islands, West Java, Banten, North Kalimantan, West Kalimantan, East Kalimantan, North Sulawesi, West Sulawesi, Central Sulawesi, South Sulawesi, Southeast Sulawesi, Gorontalo, NTB, NTT, Maluku, North Maluku, Papua and West Papua.

The analysis method used in this study is the panel data regression method. The best model to be analyzed, the Random Effect Model (REM), Fixed Effect Model (FEM), or Common Effect Model (CEM), is tested with the Chow Test and Hausman Test using the E-views application.

Furthermore, a data panel regression model is:

$$\ln EG_{it} = \beta_0 + \beta_1 C_{it} + \beta_2 \ln I_{it} + \beta_3 \ln GS_{it} + \beta_4 \ln CS_{it} + \beta_5 \ln T_{it} + \delta_{it} \quad (1)$$

Where EG is Economic Growth (GRDP), C is Household Consumption, I is Investment, GS is Goods and Services Spending, CS is Capital spending, T is Tax, β_i is the regression coefficient, i is the cross-section, t is the time series, and δ is the error term. The data used is a natural logarithmic.

4. Results and discussion

Table 2 describes the lowest and highest variables in 25 split provinces. Of the 25 split provinces, West Java has the highest GRDP, consumption, investment, goods and services expenditure, capital spending, and taxes compared to 24 other provinces. As for the position with GRDP, the lowest household consumption, investment, spending, and taxes, they occurred in several provinces over several years. However, the lowest value of GRDP, household consumption, investment, spending, and taxes, is dominated by Indonesia's central and eastern parts. These provinces have abundant natural resources, but their economic development is slower than that of the western region of Indonesia.

This table also shows the highest household consumption among investment, spending, and taxes as a driver of economic growth. This table shows that in the 25 split provinces in Indonesia, the level of household consumption is relatively high. The movement of gross regional domestic product positively responded to the positive movement of household consumption. It was conveyed in the Permana (2021) study, which said that household consumption in Indonesia accounts for around 60-75 percent of national income. However, investment is experiencing rapid development, which can later boost the economy in the split province.

Table 2: Variable data in mean, minimum and maximum (trillion rupiah)

Information		2014	2015	2016	2017	2018	2019	2020	2021	2022
GRDP	Mean	185.66	194.00	203.35	213.17	224.28	234.30	230.70	239.91	252.92
	Minimum	192.06	203.77	215.57	232.11	250.34	265.98	280.31	291.08	302.84
	Maximum	1149.23	1207.00	1275.62	1343.66	1419.62	1490.96	1453.38	1507.75	1589.99
Household Consumption	Mean	92.83	97.08	102.15	106.82	112.08	117.59	114.73	116.91	122.41
	Minimum	8.23	8.48	8.67	8.99	9.31	9.80	9.75	10.04	10.48
	Maximum	732.02	759.65	802.16	836.92	878.91	930.74	894.11	905.97	948.33
Investment	Mean	3.24	4.22	4.47	5.60	7.30	8.88	10.53	10.97	13.49
	Minimum	0.00	0.00	0.01	0.05	0.05	0.28	0.25	0.40	0.61
	Maximum	18.73	26.27	30.36	38.39	42.28	49.28	51.40	59.95	80.81
Shopping for Goods and Services	Mean	4.28	5.15	5.48	6.47	6.93	7.75	7.09	8.08	8.99
	Minimum	1.02	1.43	1.58	1.80	1.89	2.14	1.78	2.16	2.17
	Maximum	14.97	18.09	20.30	26.08	28.13	32.03	30.57	35.32	38.63
Capital spending	Mean	5.07	5.80	5.96	5.65	5.34	5.83	4.50	4.70	5.35
	Minimum	0.98	1.32	1.36	1.27	1.33	1.34	1.05	1.20	1.49
	Maximum	13.86	17.86	19.96	18.53	17.85	19.63	14.07	15.53	15.57
Tax	Mean	2.76	2.90	3.11	3.48	3.79	4.16	3.66	4.19	5.00
	Minimum	0.63	0.28	0.30	0.33	0.35	0.38	0.37	0.43	0.47
	Maximum	21.54	23.70	25.83	28.56	30.92	33.95	29.64	33.16	38.05

Source: Statistics Indonesia and Finance Ministry of Indonesia, data processed.

Table 2 also informs that average goods and services spending is greater than the average capital spending. This information explains that the procurement of goods within the scope of government that is useful in the short term (less than one year of the accounting period) is more than the procurement of assets, both fixed assets and others, that create benefits in the long term. However, it differs from taxes, where taxes continue to increase yearly except in 2020, during the COVID-19 pandemic.

Furthermore, the panel data regression method was used to answer the research objectives. The first step is to determine the best model between the Common Effect Model (CEM), Fixed Effect

Model (FEM), and Random Effect Model (REM) with the Chow test and Hausman test. The best model selection information is shown in Table 3.

Table 3: Best model testing in panel data regression

Testing	Statistics
Chow test:	
Cross-section Chi-square	121.169739
Prob	0.0000
Hausman test:	
Cross-section random	18.113649
Prob	0.0028

Source: data processed

Based on the Chow Test and Hausman Test, it is known that the best model is the Fixed Effect Model (FEM), so it is not continued to the Lagrange Multiplier Test. Furthermore, the panel data regression model presented in Table 4 is the best model (FEM).

Table 4: Panel data regression results

Variables	Fixed Effect Model (FEM)
Household Consumption	0.951726***
Investment	0.002852**
Goods and Services Spending	0.018587***
Capital spending	-0.018579***
Tax	0.031856***
C	1.050110
R-squared	0.999842
Adjusted R-squared	0.999818
F-statistic	42074.49
Prob (F-statistic)	0.000000

Source: data processed, 2024

Description: *** signifies at 1%, and ** signifies at 5%

Table 4 shows that four independent variables have a significant positive effect on economic growth. These four variables are household consumption, investment, goods and services spending, and taxes. Meanwhile, capital spending has a significant negative influence on economic growth. So, it can be written in the regression model as follows:

$$\text{LnEG}_{it} = 1.050 + 0.951 \text{LnC}_{it} + 0.002 \text{LnI}_{it} + 0.018 \text{LnGSS}_{it} - 0.018 \text{LnCS}_{it} + 0.031 \text{LnT}_{it} \quad (2)$$

Partially, household consumption significantly influences economic growth, as shown by a coefficient of 0.951726 and a probability value of 0.0000, which is less than 0.05. If household consumption increases, it will also increase economic growth in the 25 split provinces. This is in line with research by Handriyani *et al.* (2018), Purnama *et al.* (2022), and Hakib (2019), which showed that household consumption had a significant positive effect on economic growth. Increasing household consumption means increasing the demand for goods and services, so producers will increase the production of goods and services, leading to economic growth. According to Keynesian theory, increasing household consumption will have a multiplier effect on increasing economic growth.

Furthermore, investment significantly influences economic growth, as shown by a coefficient of 0.002852 and a probability of 0.0307, which is less than 0.05. So if investment increases by 1%, economic growth increases by 0.002852%. If investment increases, economic growth will increase in the 25 split provinces. This is in line with the studies of Digidowiseiso (2021), Fachrizal *et al.* (2021), Arlintang *et al.* (2020), and Winarni *et al.* (2020). Investment drives long-term economic growth and increases aggregate spending. Through investment, production capacity will expand, creating jobs, reducing unemployment, increasing demand and consumption of goods and services, and increasing per capita income. Thus, investment capital is a crucial instrument in regional development. Due to the low capital capacity in developing countries such as Indonesia, investment is one of the factors that hinder economic growth.

This study also found a significant favorable influence of goods and services spending on economic growth at $\alpha = 5\%$. Every 1% increase in goods and services spending will also increase economic growth by 0.018587%. If the government increases goods and services spending, it will also increase economic growth in the 25 split provinces. This study is parallel to previous research (Ogundipe & Oluwatobi, 2013; Modebe *et al.*, 2012; Rambe & Febriani, 2020; Desmon *et al.*, 2012;

and Mawaddah *et al.*, 2024). Goods and services spending needed by the government will make producers and service providers strive to meet the needs of these goods and services to meet and serve the community's needs. This condition leads to an increase in economic activity, which will ultimately boost economic growth.

In contrast to the positive influence of goods and services spending, it turns out that capital spending has a significant negative effect on economic growth at $\alpha = 5\%$. An increase in capital spending of 1% will reduce economic growth by 0.018579%. Increasing capital spending will also reduce economic growth in the 25 split provinces if the government increases capital spending. These results support the research conducted by Agyeman *et al.* (2022), Pangestu (2018), Astrayasa & Yasa (2019), and Putra *et al.* (2022). Increasing capital spending can reduce economic growth if its use is not carried out effectively and efficiently, such as improper supervision, immature planning, or improper management of capital spending in projects.

Regional revenues, namely tax revenues, also influence economic growth. The results of this study show that taxes have a significant positive effect on economic growth at $\alpha=5\%$. If tax revenues increase, it will also increase economic growth in the 25 split provinces. This is in line with research conducted by Acosta-Ormaechea *et al.* (2019), Amri (2020), Ofoegbu *et al.* (2016), Yunita & Sentosa (2019), and Alkasasbeh *et al.* (2018). Tax revenue is a source of government revenue that drives the wheels of the regional economy. Taxes are a means by which the government regulates fiscal policy. As economic growth increases, so does taxpayers' ability to pay local taxes. Thus, the increase in regional tax revenues is positively correlated with economic growth.

Furthermore, the regression model of the panel data shows that each province has an initial constant. The sum of the model's constants plus the provinces' initial constants produces a specific constant for each province. From the specific constant, it is possible to identify which provinces have economic growth that is more or less than average. This information is presented in Table 5.

Table 5: Specific constanta and provincial GRDP based on panel data regression model

Provinces	Initial	Constanta	Specific Constanta for Province	GRDP (IDR billion)
Aceh	-0.0696	1.0501	0.980	2.665
North Sumatra	-0.0092	1.0501	1.040	2.831
Riau	0.1549	1.0501	1.205	3.337
Jambi	0.0340	1.0501	1.084	2.956
South Sumatra	-0.1623	1.0501	0.887	2.429
Bengkulu	-0.1477	1.0501	0.902	2.465
Riau Island	0.0733	1.0501	1.123	3.0757
Lampung	-0.0891	1.0501	0.961	2.614
West Java	0.0749	1.0501	1.125	3.080
Banten	-0.0725	1.0501	0.977529	2.657
West Kalimantan	-0.0533	1.0501	0.996726	2.709
East Kalimantan	0.4915	1.0501	1.541650	4.672
North Kalimantan	0.4149	1.0501	1.465089	4.327
North Sulawesi	-0.0083	1.0501	1.041807	2.834
Central Sulawesi	0.0443	1.0501	1.094444	2.987
South Sulawesi	-0.0301	1.0501	1.019928	2.772
West Sulawesi	-0.0534	1.0501	0.996711	2.709
Southeast Sulawesi	-0.0030	1.0501	1.047091	2.849
Gorontalo	-0.1435	1.0501	0.906557	2.475
NTB	-0.1147	1.0501	0.935394	2.548
NTT	-0.2164	1.0501	0.833666	2.301
Maluku	-0.1644	1.0501	0.885674	2.424
North Maluku	-0.0789	1.0501	0.971146	2.640
Papua	0.0565	1.0501	1.106672	3.024
West Papua	0.2223	1.0501	1.272482	1.249

Source: data processed

Table 5 explains each province's specific constant. Provinces with specific constants more than average are Riau, Jambi, Riau Island, West Java, East Kalimantan, North Kalimantan, Central Sulawesi, Papua, and West Papua. Sixteen other provinces are below the average. The highest initial constant is found in East Kalimantan Province at 0.491, so the specific constant of this province is 1.541. Vice versa, the lowest initial constant is in NTT Province -0.216, and the specific constant of this province is 0.833.

5. Conclusion

Economic growth in split provinces of Indonesia is significantly influenced by multiple factors, as revealed by our panel data analysis of 25 provinces from 2014 to 2022. Our findings demonstrate that household consumption, investment, goods and services spending, and taxes positively affect economic growth, while capital spending has a negative impact.

These results have important implications for policymakers and regional development strategies:

- The strong positive influence of household consumption underscores the need for policies that boost consumer spending and purchasing power in split provinces. This could include targeted social welfare programs or initiatives to increase disposable income.
- The positive impact of investment highlights the importance of creating a favorable business climate to attract domestic and foreign investments. Local governments should focus on improving infrastructure, streamlining bureaucratic processes, and offering incentives to investors.
- The positive effect of goods and services spending suggests that efficient government expenditure can stimulate economic growth. Policymakers should prioritize spending on areas directly contributing to economic activities and public welfare.
- The negative impact of capital spending is a concern that requires further investigation. It suggests a need for more effective planning, implementation, and monitoring of capital projects to ensure they contribute positively to economic growth.
- The positive influence of taxes on economic growth indicates that a well-designed tax system can support economic development. Policymakers should focus on optimizing tax collection while ensuring it does not hinder economic activities.

Our research contributes to the growing body of literature on regional economic growth in developing countries, particularly in the context of administrative restructuring. It provides empirical evidence that can guide policy formulation for newly formed provinces.

However, this study has limitations that future research should address. These include potential endogeneity issues and the need for a more granular analysis of specific government spending and investment types. Additionally, investigating the long-term effects of these determinants and incorporating qualitative factors such as governance quality could provide a more comprehensive understanding of economic growth dynamics in split provinces.

In conclusion, our findings emphasize the complex interplay of factors influencing economic growth in Indonesia's split provinces. They highlight the need for tailored, evidence-based policies that consider these regions' unique characteristics and challenges to foster sustainable economic development.

Declarations

Ethics approval and consent to participate

Not applicable.

Consent for publication

Not applicable.

Availability of data and material

The data are available on request.

Competing interests

The authors declare no conflict of interest or competing interests.

Funding

This work received no funding.

Citation information

Fitriani, N. Y., & Rambe, R. A. (2024). What determines economic growth in the split province in Indonesia?. *Economics, Management and Sustainability*, 9(2), 72-83. doi:10.14254/jems.2024.9-2.6

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Economics, Management and Sustainability (ISSN: 2520-6303) is published by Scientific Publishing House "CSR", Poland, EU and Scientific Publishing House "SciView", Poland

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