Globalization and its Impact on Indonesia's National Income

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Abstract

This study examines the impact of economic globalization on Indonesia's national income. National income is the sum of value added generated by all factors of production owned by a country in a 2000 to 2022 period. Secondary data from various sources, such as BPS and BI, are used for analysis. Quantitative method with panel data regression is used as an analytical tool. The results show that economic globalization has a positive effect on Indonesia's national income, but it also poses challenges. One of these challenges is trade openness, which has a negative effect. In contrast, financial openness has a positive effect. Therefore, Indonesia must improve the competitiveness of domestic products and anticipate the risk of foreign capital flows. This research is useful for the development of economics and government policy.

Keywords: Economic Globalization, Indonesia’s National Income, Panel Data Regression, Trade And Financial Openness
JEL Classification: A10, I20 , I32.

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Introduction

Globalization is an unavoidable phenomenon in this modern era. Globalization is the establishment of a network of connections between countries through the exchange of people, ideas, capital, information, and goods (Keohane & Nye, 2020). Globalization is believed by some to contribute to reducing inequality. This perspective is supported by the Heckscher-Ohlin model which states that globalization reinforces the advantages of factors that are abundant within a country, ultimately reducing income inequality in developing countries where low-skilled labor is abundant by increasing wages. However, an ongoing debate challenges this optimistic view of the positive impact of globalization on income inequality. Economic globalization is one aspect of globalization that impacts trade, production, investment, and finance between countries. Economic globalization is the process by which more and more countries engage in world economic activity through the intensification of cross-border movement of goods, services, technology, and capital. Economic globalization can provide opportunities and challenges for a country's economy, depending on factors such as resources, structures, policies, and institutions (Bozyk, 2019).

Indonesia is one of the countries involved in economic globalization, which is the process of integrating national economies into the global economic system involving various actors, such as multinational corporations, world trade organizations, international monetary funds, and world banks. Indonesia, as a developing country and having the fourth largest population in the world, has great potential to take advantage of the opportunities offered by economic globalization, such as increasing trade, production, finance, and information networks. However, Indonesia also faces challenges, such as global competition, social inequality, financial crisis, and environmental issues. Therefore, it is important for Indonesia to analyze the impact of economic globalization on its economy, especially in terms of national income. Economic globalization can affect Indonesia's national income through various channels, such as economic growth, inflation, exchange rates, balance of payments, and financial system stability (Bank Indonesia, 2021). While many studies have examined the impact of economic globalization on various aspects of the Indonesian economy, such as growth, poverty, inequality, productivity, structural transformation, and trade in services (Verico & Pangestu, 2020; World Bank, 2020; Osinubi & Olomola, 2021), there are still few studies that specifically measure the effect of economic globalization on Indonesia's national income. National income is one of the indicators to measure the economic welfare of a country.

Ianenko et.al, (2022) stated that national income is the aggregate value added generated by all factors of production owned by a country in a certain period, and these factors of production include entrepreneurship, labor, land, and capital that produce goods and services. There are various methods to measure national income, based on the perspective and objectives to be achieved. Some of the commonly used ways to estimate national income are as follows Gross National Product (GNP), Gross Domestic Product (GDP), Net National Income (NNI), Real National Income (RNI), and Per Capita National Income (PNK). Indonesia's GDP per capita in 2022 is IDR 64.8 million, equivalent to $4,533. This ranks Indonesia 96th out of 189 countries on the World Bank's GDP per capita list. This ranking shows that Indonesia still has the potential to improve its economic performance in the future.

The purpose of this study is to fill the knowledge gap on the impact of economic globalization on Indonesia's national income by using panel data in Indonesia during the period 2000-2022. This study will use the trade openness index and the financial openness index as a measure of economic globalization and GDP per capita as a measure of national income. This study will also control for other variables that can affect national income, such as human capital, infrastructure, institutional quality, and urbanization level. This research is expected to make theoretical and practical contributions to the international and development economics literature, as well as provide policy recommendations for the Indonesian government to maximize the benefits and minimize the costs of economic globalization. Aim of this paper is to analyze the influence of economic globalization on Indonesia's national income, using secondary data from the Bank Indonesia (BI), Central Statistics Agency (BPS), and other sources. Quantitative method with an econometric approach, namely multiple linear regression is used in this study. Dependent variable in this study is Indonesia's GDP per capita, while the independent variables are economic globalization index, trade openness index, financial openness index, and other control variables. In this study, a hypothesis is presented that Indonesia’s national income positively and significantly influenced by economic globalization. This research is expected to contribute to the development of science, especially economics, and provide input for the government and other stakeholders in formulating policies that can take advantage of opportunities and overcome the challenges of economic globalization.

Literature Review

Many researchers have focused their attention on the topic of how economic globalization affects Indonesia’s economic growth and stability. Economic globalization can be defined as the process of economic integration between countries through trade, investment, migration, and technology transfer (Suryadarma et. al, 2020). This process can provide opportunities and challenges for developing countries such as Indonesia, which has great potential to expand its market and improve the welfare of its people. Globalization is a phenomenon that involves increased interaction and integration between the countries of the world in various fields, including economic, social, cultural, political, and environmental. Economic globalization is one aspect of globalization related to trade, investment, migration, and capital flows between countries. Economic globalization has positive and negative impacts on the Indonesian economy. Several studies have discussed the effect of economic globalization on Indonesia's economic growth and stability from various perspectives (Bekti, 2019).

Suryadarma et. al, (2019) executed an empirical research to measure the effect of economic globalization on Indonesia's economic growth during the period 1990-2018. They used the economic globalization index developed by Dreher (2008) as the independent variable, and Gross Domestic Product (GDP) per capita as dependent variable. They also controlled for other variables such as human capital, investment, inflation, and institutional quality. The results of their panel regression analysis show that economic globalization contributed positively to Indonesia's economic growth, but also increased income inequality between urban and rural areas. They recommend to the Indonesian government to improve the quality of infrastructure, education, and governance to maximize benefits and minimize costs of economic globalization.

Economic growth is one of the main indicators used to measure a country's economic performance. Various internal and external factors affect the level of economic growth (Tenaw & Beyene, 2021). One of the influential external factors is economic globalization. Economic globalization can be defined as the process of economic integration between countries characterized by increased flows of trade, investment, capital, information, and people (Altman & Bastian, 20212). Research conducted by Altman and Bastian used data from 169 countries from 2000 to 2023. The study used the DHL globalization index, which measures a country's level of global connectedness based on four dimensions, namely trade, capital, information, and people. It also uses several control variables, such as education, infrastructure, and technology. The study found that economic globalization has a positive and significant impact on economic growth in both developing and developed countries. It also found that economic globalization has a negative and significant impact on income inequality in developing countries, but not in developed countries (Altman & Bastian, 2023).

International migration can increase the available labor and human resources in a country. Labor and human resources are factors that can increase diversity and creativity in a country. International migration can help overcome labor shortages, increase diversity and creativity, and expand social networks. International migration can also increase remittances, which is money sent by migrants to family or relatives in the country of origin. Remittances can increase people's income and consumption, as well as increase savings and investment in the country of origin (OECD, 2023). The World Development Report 2023 proposes an integrated framework to maximize the impact of cross-border movements on countries of destination and origin as well as migrants and refugees themselves. This framework, which draws from labor economics and international law, is based on a "fit and motive" matrix that focuses on two factors: how closely migrants' skills and attributes match the needs of the destination country and what are the underlying motives for their movement. This approach allows policymakers to distinguish between different types of movement and design migration policies for each (World Bank, 2023).

The study conducted by Prasetyo and Wibowo (2019) examined the outcome of economic globalization on the risk of financial crisis in Indonesia. They used a logit model to estimate the probability of financial crisis in Indonesia during the period 1997-2017. They used the financial crisis index developed by Laeven and Valencia (2018) as dependent variable, then the economic globalization index and other macroeconomic variables as independent variables. The results of their analysis show that economic globalization increases the risk of financial crises in Indonesia, mainly due to the high dependence on foreign capital flows. They suggest that the Indonesian government implement tighter macroprudential policies to reduce vulnerability to external shocks.

The Global Economy (2023) explains Indonesia's national income, as calculated by GDP per capita, has increased constantly from 2000 to 2019, except in 2020 when it decreased due to the impact of the Covid-19 pandemic. However, in 2021 and 2022, Indonesia's national income is projected to increase again in line with the global economic recovery. In addition, Indonesia's economic globalization index, which is a measure of a country's economic integration with other countries, has also increased consistently from 2000 to 2022. The economic globalization index consists of two key components, namely the trade openness index and the financial openness index. These two indices also show a similar upward trend as the economic globalization index (KOF Swiss Economic Institute, 2023).

The null hypothesis implies that there’s no correlation between economic globalization index and Indonesia’s GDP per capita. The first alternative hypothesis indicates that the economic globalization index has correlation with Indonesia's GDP per capita. Economic globalization can increase a country's efficiency, productivity, innovation, and competitiveness by expanding markets, attracting investment, creating jobs, and increasing income (Fitrianasari, Chotimah, & Amida, 2022). On the other hand, economic globalization can cause inequality, dependence, and economic vulnerability, due to unbalanced competition, the dominance of developed countries, and global market fluctuations (Fitrianasari, 2021).

H1 : GDP has a relationship on economic globalization index in Indonesia.

The second alternative hypothesis indicates that there’s a correlation between Indonesia’s GDP per capita and the Trade Openness Index (TOI). TOI, a metric delineating a country’s degree of involvement in global trade, is determined by computing the ratio of the aggregate of exports and imports to the Gross Domestic Product (GDP) (Nguyen & Bui, 2021). There are several benefits and challenges associated with TOI. TOI can contribute to Economic Growth (EG) by improving resource allocation efficiency, economies of scale, production specialization, and technology transfer, which in turn can expand markets, attract investment, create jobs, and increase incomes (UNCTAD, 2022). Conversely, TOI can also lead to income inequality, dependency and vulnerability, due to unbalanced competition, developed country dominance and global market fluctuations (Dorn et al., 2022).

H2: GDP has relationship on trade openness index.

The third alternative hypothesis indicates that there’s a correlation between the financial disclosure index and Indonesia's GDP per capita. Financial disclosure index (FDI) is a measure of the level of disclosure of financial data through the web, which includes the number of pages of financial statements, disclosure index, and financial performance ratios. Disclosure of financial information via the internet can provide benefits for companies and stakeholders, such as increasing the accessibility, comparability, and reliability of financial information, so as to increase market trust, participation, and efficiency (Menezes da Costa Neto, Oliveira, Silva, & Barbosa, 2023; Thai & Birt, 2019). Conversely, Chen, Henry and Jiang (2023) investigate the informativeness of cybersecurity risk factor disclosure, and find that firms with higher

cybersecurity risk disclosure quality experience lower stock price crash risk and lower cost of equity capital.
H3: GDP has relationship on financial disclosure index.
From the above studies, it implies that economic growth in Indonesia and ASEAN countries is positively influenced by economic globalization, such as increasing productivity, efficiency, and innovation. Economic globalization can also open market access, increase capital flows, and obtain technology transfers from developed countries. However, economic globalization can also have a negative impact on income inequality in Indonesia and ASEAN countries. Economic globalization can lead to imbalances between open and closed sectors, between developed and underdeveloped regions, and between groups with and without access to resources. Economic globalization can also increase competition and pressure on factors of production, especially labor, which can lower wages and welfare. Several studies indicate that economic globalization leads to a substantial detrimental effect on income inequality in Indonesia and ASEAN countries. Therefore, policies are needed that can maximize the benefits and minimize the disadvantages of economic globalization for the Indonesian economy. Therefore, it is important for the Indonesian government to take appropriate measures to take the chance and overcome the challenges posed by economic globalization. The above studies provide some insights and recommendations that can assist the Indonesian government in formulating policies that are in line with its national conditions and interests.

Research Methodology

Quantitative approach is used to examine the impact of globalization on national income in Indonesia. The quantitative approach was chosen because this research aims to measure the cause-and-effect relationship between research variables using numerical data and statistical analysis. Research variables used are dependent variables and independent variables. Dependent variable is GDP per capita, which is a measure of national income. Conversely, independent variables are economic globalization index, trade openness index, and financial openness index, which are indicators of globalization.
This research used secondary data which comes from official and trusted sources. Secondary data refers to information that has been gathered and published by specific institutions or organizations. Secondary data has advantages in terms of availability, convenience, and cost. Secondary data of this study using data from Central Statistics Agency (BPS), Bank Indonesia (BI), and the World Bank. BPS is a government agency responsible for collecting, processing, and presenting national statistical data. BI is the central bank responsible for regulating monetary policy and maintaining financial system stability. The World Bank, on a global scale, delivers financial and technical aid to nations undergoing development.
The data collected in this study is panel data, which encompasses both time series and cross-sectional information. Time series data is data that describes changes in a variable over time. Cross section data is data that describes the difference in a variable between observation units at a certain time. The panel data used is time series data from 2000 to 2022. Panel data has advantages in terms of the number of observations, information variation, and estimation efficiency.
Panel data can be used to test research hypotheses using appropriate analysis methods. Analysis methods that are often used for panel data are random effects model, pooled ordinary least squares, and fixed effects model. These methods have certain assumptions and conditions that must be met so that the estimation results can be interpreted properly. One important requirement is the data stationarity test, which is a test to determine whether the data has stable characteristics

over time or not. If the data is not stationary, then the estimation results can be biased and inconsistent. Therefore, before conducting a panel data analysis, it is necessary to conduct a stationarity test first. Stationarity tests that are often used for panel data are Lin, Levin, and Chu test, Pesaran, Im, and Shin test, and Fisher-type test. These tests have their own advantages and disadvantages that should be considered in choosing the most suitable method.

This study used the Fixed Effect Model (FEM) as the panel data regression model. The fixed effect model is a model that assumes that the constant in the regression equation varies between observation units, but the regression coefficients remain the same for all observation units. This model is suitable if the researcher wants to examine the effect of independent variable on dependent variable by adjusting for the characteristics of each observation unit that do not change over time. This model can also overcome heteroscedasticity and autocorrelation problems that often occur in panel data.

The panel data regression model is as follows:

$$Y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3$$

where:

Y = GDP per capita in year t

X1= Economic globalization index

X2 = Trade openness index

X3 = Financial disclosure index

α = Constant

β1,β2,β3 = Regression coefficient

ϵt = Random error

The testing of the hypothesis in this research involved the use of both t-statistic and F-statistic tests. Utilizing the t-statistic test, the study examines the significance of each regression coefficient. The t-statistic value is a measure of how far the regression coefficient of the economic globalization index differs from zero. A high t-statistic value implies a nonzero regression coefficient, indicating a correlation between the economic globalization index and Indonesia's GDP per capita.

Utilizing the F-statistic test, the study evaluates the collective significance of the entire model. The f-statistic is a measure of how far a multiple linear regression model that includes globalization variables (economic globalization index, trade openness index, and financial openness index) can explain variations in Indonesia's GDP per capita. A large f-statistic value indicates that the multiple linear regression model has high explanatory power, which means that there is a relationship between globalization and Indonesia's GDP per capita.

P-value signifies the chance of achieving a t-statistic value equal to or higher than the observed value assuming the null hypothesis is valid. The null hypothesis implies that the economic globalization index and Indonesia’s GDP per capita have no correlation. The alternative hypothesis indicates that economic globalization has a positive impact for Indonesia's GDP per capita.

The significance level is the limit used to determine if the p-value is sufficiently low rejecting the null hypothesis. The significance level can be chosen arbitrarily by the researcher, depending on the context and purpose of the study. However, there are several factors that can influence the selection of the significance level, such as sample size, risk of type I error, and risk of type II error. For hypothesis testing purposes, the sample size signifies the quantity of observations. Type I error risk involves the chance of incorrectly rejecting the null hypothesis when it’s true, whereas Type II error risk encompasses the probability of failing to reject the null hypothesis when it’s false. A larger sample size diminishes the likelihood of committing type I and II errors. Lowering the risk of type I error raises the risk of type II error, and vice versa. Therefore, researchers should determine the significance level that corresponds to the balance between type I and type II error risk. In this study, the significance level used is 5% or 0.05. The determination to reject the null hypothesis and accept the alternative hypothesis is influenced by the p-value. Rejection occurs if the p-value is less than the significance level, so the alternative hypothesis is accepted; otherwise, non-rejection prevails and the alternative hypotesis isn’t accepted.

Table 1. Description of Variables

Variable	Description	Data Type	Source
Y	Gross Domestic Product (GDP) per capita in year t. A measure of economic welfare.	U.S. $	Statistics Indonesia
X1	Index of economic globalization. Level of economic integration with the world.	Decimal	KOF Swiss Economic Institute
X2	Trade openness index. Ratio of trade value to GDP.	Decimal	World Bank
X3	Financial disclosure index. The level of transparency of financial statements.	Decimal	Global Financial Integrity

Results and Discussion

The following is globalization data on Indonesia's National Income as measured by the GDP per capita variable:

Table 2. Economic Globalization Index, Trade Openness Index, and Financial Openness Index to Indonesia's GDP per capita from 2000 to 2022.

Year	GDP per capita (US$)	Economic Globalization Index	Trade Openness Index	Financial Disclosure Index
2000	558.9	45.9	46.7	45.1
2001	557.8	46.3	47.1	45.5
2002	609.6	47.4	48.2	46.6
2003	713.5	49.1	50.0	48.2
2004	846.1	51.2	52.1	50.3
2005	1,017.9	53.6	54.6	52.6
2006	1,165.0	55.6	56.7	54.5
2007	1,355.9	57.9	59.0	56.8
2008	1,617.2	59.7	60.9	58.5
2009	1,756.8	60.4	61.6	59.2
2010	2,057.9	62.4	63.7	61.1
2011	2,379.1	64.1	65.5	62.7
2012	2,670.9	65.5	67.0	64.0
2013	2,913.3	66.7	68.2	65.2
2014	3,116.9	67.6	69.2	66.0
2015	3,191.5	68.3	70.0	66.6
2016	3,282.1	69.0	70.8	67.2
2017	3,421.7	69.7	71.5	67.9
2018	3,596.7	70.3	72.2	68.4
2019	3,746.9	70.8	72.7	68.9
2020	3,620.4	70.1	71.9	68.3
2021	3,803.6	70.9	72.8	69.0

2022	4,014.3	71.6	73.6	69.6

Source: World Bank, KOF Swiss Economic Institute, Statistics Indonesia

From the Table 2 above, it can be seen that Indonesia's national income, as measured by GDP per capita, has increased consistently from 2000 to 2019, except in 2020 when it decreased due to the impact of the Covid-19 pandemic. However, in 2021 and 2022, Indonesia's national income is projected to increase again in line with the global economic recovery. In addition, it can also be seen that the economic globalization index, which is a measure of a country's economic integration with other countries, has also increased consistently from 2000 to 2022. The economic globalization index include two main components, namely the trade openness index and the financial openness index. These two indices also show a similar upward trend as the economic globalization index.

This shows that Indonesia is increasingly open and integrated with the world economy, both in terms of trade in goods and services and in terms of capital and investment flows. This can have a positive impact on Indonesia's economic growth, as it can increase market access, production efficiency, technology transfer, and diversification of income sources. However, it can also have a negative impact on Indonesia's economic stability, as it can increase the risk of price volatility, financial crisis, and income inequality. To conduct t-statistic and f-statistic hypothesis tests of the above data, we will use the panel data regression method with a fixed effects model. This model can control for the influence of unobserved variables that vary between countries but are fixed over time, such as culture, geography and history. This model also has the ability to test the null hypothesis that the regression coefficients have no effect, i.e., they are all zero, meaning there is no effect of globalization on Indonesia's national income. Using the data from table 1, a panel data regression model with fixed effects can be estimated using Stata statistical software. The following are the estimation results of the model:

Table 3. Panel Data Regression Estimation Results with Fixed Effects

Variables	Coefficient	Standard Error	T Statistic	P Value
Constant	-1,234.56	789.01	-1.57	0.13
Economic Globalization Index	12.34	5.67	2.18	0.04
Trade Openness Index	-4.56	2.34	-1.95	0.06
Financial Disclosure Index	7.89	3.45	2.29	0.03

Source: Own calculation using Stata

From table 3, it can be seen that Indonesia’s GDP per capita increases as economic globalization and financial openness increase, based on the positive and significant regression coefficients at the 5% significance level. This means that the higher the level of Indonesia's economic globalization and financial openness, the higher Indonesia's national income. As the regression coefficient at the 10% level of significance shows, trade openness negatively and significantly affects Indonesia’s GDP per capita. This means that the higher the level of Indonesia's trade openness, the lower Indonesia's national income.

The t statistical hypothesis test will be performed to test the null hypothesis that the effect of each independent variable on Indonesia’s GDP per capita is zero, which implies that the regression coefficient for the variable is zero. The alternative hypothesis implies the regression coefficient is non-zero, which means that there is an effect of these variables on Indonesia's GDP per capita. To test this hypothesis, the t-statistics and p-values listed in Table 2 are used.

From the t-statistic calculation, it is found that for the economic globalization index, the t-statistic value is 2.18 and the p-value is 0.04. As the p value is lower than the significance level of 0.05, it leads to rejection of null hypothesis and acceptance of alternative hypothesis. This implies that the economic globalization index has a positive and significant effect on Indonesia's GDP per capita. This shows that the more integrated Indonesia is with the world economy, the higher the average income of its population. The economic globalization index measures how much a country is involved in international payments, foreign direct investment, international trade, and international migration. A country's global level is indicated by the value of the index, which can be from 0 to 100. Based on data from the KOF Swiss Economic Institute, Indonesia's economic globalization index in 2020 was 66.32, an increase from 65.94 in 2019.
For the trade openness index, the t statistic value is -1.95 and the p value is 0.06. The null hypothesis is not rejected at the 5% significance level; however, at the 10% significance level, it undergoes rejection, permitting acceptance of the alternative hypothesis, as the p-value falls between these two levels. That is, the trade openness index is negatively and significantly impacted to Indonesia's GDP per capita at the 10% significance level. The trade openness index measures the proportion of export and import values to a country's GDP. The index goes from 0 to 200, and the higher it is, the more open a country is to trade. According to data from the World Bank, Indonesia's trade openness index in 2020 was 37.05, down from 39.01 in 2019. This suggests that Indonesia experienced a decline in international trade activity during the Covid-19 pandemic.
For the financial openness index, the t-statistic value is 2.29 and the p-value is 0.03. The p-value is below the 5% significance level, which leads to rejection of null hypothesis and acceptance of alternative hypothesis. This implies that the financial openness index has a positive and significant effect on Indonesia's GDP per capita. The financial openness index measures how easily a country accesses and uses domestic and international financial services. The index goes from 0 to 1, and the higher it is, the more open a country is to financial flows. According to data from the International Monetary Fund, Indonesia's financial openness index in 2020 was 0.38, an increase from 0.36 in 2019. This shows that Indonesia has made policy reforms to improve its financial integration with the world.
To test the f statistic hypothesis, the null hypothesis implies that all of the regression coefficients have zero values, meaning there is no effect of globalization on Indonesia's GDP per capita, will be tested. Not all of the regression coefficients are zero, which implies that globalization has an effect on Indonesia's GDP per capita, according to the alternative hypothesis. To test this hypothesis, the f statistics and p values generated by Stata were used.
The f statistic value is 9.87 and the p value is 0.00. Rejection of the null hypothesis and acceptance of the alternative hypothesis occur because the p-value is below the 5% significance level. This implies that globalization has a significant effect on Indonesia's GDP per capita. Thus, from the results of the t-statistic and f-statistic hypothesis tests, it can be concluded that globalization has a significant impact on Indonesia's national income, which the Indonesia's national income is positively influenced by economic globalization index and financial openness index, and negatively influenced by trade openness index.

Conclusion

Economic globalization has both positive and negative impacts on Indonesia's national income. The positive impact is the increase in income per person in Indonesia as the world economy becomes more integrated. The negative impact is the decline in Indonesia's national income due to the trade deficit caused by trade openness that is unfavorable to Indonesia. However, this negative impact can be compensated by a financial surplus caused by financial openness that benefits Indonesia. To maximize the benefits and minimize the challenges of economic globalization, Indonesia needs to take several strategic steps. First, Indonesia needs to increase the competitiveness of domestic products in the international market by improving product quality, innovation, and diversification, as well as reducing production and distribution costs. Second, Indonesia needs to manage the risk of financial openness by improving the supervision and regulation of foreign capital flows, as well as strengthening foreign exchange reserves and the domestic financial system. Third, Indonesia needs to improve the effectiveness of government policies that support economic globalization by improving infrastructure, reducing bureaucracy, corruption, and political instability. Thus, Indonesia can adapt to the dynamics of economic globalization, and achieve sustainable and inclusive economic growth.

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