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## DAFTAR ISI

PERENCANAAN OPERASIONAL BRITISH PETROLEUM ACTIVE MOBILE FUEL STATION PT WHEZ ENERGI SEJAHTERA 01 - 20
Zatmiko Setiawan
Rhian Indradewa
Dimas Angga Negoro
Edi Hamdi

PERSPEKTIF EKONOMI ISLAM TERHADAP FAKTOR PENDUKUNG EKSISTENSI PASAR TRADISIONAL PANORAMA KOTA BENGKULU 21 - 37
Pajri Abdul Ajis
Idwal
Padlim Hanif

PEMASARAN PRODUK UMKM PADA KELOMPOK TANI KECAMATAN ENGGANO (Program Guidance For Marketing Of Umkm Products In Farmers' Groups In Enggano District) 38 - 50
Arbit Khopangsang
Eka sri Wahyuni
Yenti Sumarni

PENGARUH CUSTOMER SATISFACTIONT DAN CORPORATE REPUTATIONT TERHADAP LOYALITAS PELANGGAN (Studi Pada Pelanggan PT. JNE Kota Bengkulu) 51 - 60
Meilaty Finthariasari
Zicco Fernandez
Subandrio
Dedi Wahyudi

ADOPSI QRIS OLEH PEDAGANG TERAS MALIOBORO 1: ANALISIS KUALITAS LAYANAN DAN KEMUDAHAN PENGGUNAAN 61 - 71
Avilla Nadhif Firjatullah
Wahyu Hidayat Riyanto
Subandrio
Dimas Bagus Wiranatakusuma

PENGARUH DIGITAL MARKETING DAN ELECTRONIC WORD OF MOUTH (E-WOM) TERHADAP MINAT BERLANGGANAN LAYANAN STREAMING VIDEO-ON-DEMAND NETFLIX (STUDI PADA MAHASISWA AKTIF DI MALANG) 72 - 87
Abdullah As Shoib
Arief Noviarakhman Zagladi
Wahyu Hidayat Riyanto

PELANGGARAN ETIKA DAN KEBIJAKAN STUDI MENGENAI PERDAGANGAN ILEGAL PAKAIAN BEKAS IMPOR DI LINGKUP PENGUSAHA THRIFTING 88 - 103
Belva Sharafina
Dinar Asriningpuri
Khalila Zalema

PERAN KUALITAS PRODUK DAN INFLUENCER DALAM MEMBANGUN KEPERCAYAAN NASABAH SERTA IMPLIKASINYA PADA KEPUTUSAN PEMBIAYAAN KPR DI BANK XYZ SYARIAH 105 - 117
Elisa Purnawati

APLIKASI METODE ANALYTICAL HIERARCHY PROCES (AHP) DALAM UPAYA MENINGKATKAN WISATA HALAL (DI WISATA RINDU HATI KABUPATEN BENGKULU TENGAH) 118 - 135
Andre Noprendi
Andang Sunarto
Nonie Afrianty

PENGARUH PERFORMANCE EXPECTANCY, EFFORT EXPECTANCY, DAN SOCIAL INFLUENCE TERHADAP ADOPSI E-COMMERCE DI KALANGAN GENERASI MILENIAL 136 - 147
Fitri Syakinah
Irfan Rizki Gumilar
Reny Dany Merliyana

ANALISIS PELAKSANAAN KONTRAK EMAS SYARIAH (Studi Bank Jatim Syariah Cabang Pembantu Sampang) 148 - 158
Imam Syafi'e
Muhtadi Ridwan
Irmayanti Hasan

FINANCIAL LITERACY DAN FINANCIAL SECURITY: PERAN MEDIASI FINACIAL BEHAVIOR 159 - 172
Lauren Prastika Marfia Putri
Muhammad Ali Fikri

PERCEPTIONS AND PURCHASE INTENTIONS OF MUSLIM AND NON-MUSLIM CONSUMERS FOR ISLAMIC RETAILING 173 - 185
Asyidatur Rosmaniar
Ali Imaduddin Futuwwah
Awanis Ku Ishak
Alvia Poppy Nurjayanti

PENGARUH LABA BERSIH, ARUS KAS OPERASI, KESEMPATAN INVESTASI, KEBIJAKAN HUTANG DAN PERTUMBUHAN ASET TERHADAP KEBIJAKAN DEVIDEN (Studi Pada Perusahaan Food And Beverage 2019-2021) 186 - 203
Desi Fitria
Yazi Hamzah

PENGARUH PERCEIVED ORGANIZATIONAL SUPPORT, PENGEMBANGAN KARIR, DAN KOMPENSASI TERHADAP KOMITMEN ORGANISASI PERAWAT PADA RSU PKU MUHAMMADIYAH BANTUL 204 - 226
Sekar Dwi Hidayati
Epsilandri Septyarini
Tri Ratna Purnamarini

PENGARUH PERCEIVED ORGANIZATIONAL SUPPORT, PENGEMBANGAN KARIR, DAN KOMPENSASI TERHADAP KOMITMEN ORGANISASI PERAWAT PADA RSU PKU MUHAMMADIYAH BANTUL 227 - 236
Sekar Dwi Hidayati

Epsilandri Septyarini
Tri Ratna Purnamarini

PERSPEKTIF EKONOMI ISLAM TERHADAP STRATEGI PEMASARAN DI TOKO AL MUAWANAH MART UIN FATMAWATI SUKARNO BENGKULU DALAM MENARIT MINAT BELANJA KONSUMEN 237 - 256
Robin Syahputra
Idwal
Citra Liza

POVERTY STUDY IN BENGKULU PROVINCE (INCLUSIVE DEVELOPMENT INDEX REVIEW) 257 - 271
Barika
Aan Zulyanto

PENGARUH KUALITAS PELAYANAN, KOMUNIKASI INTERPERSONAL, DAN DISIPLIN KERJA TERHADAP KEPUASAN MASYARAKAT PADA KANTOR DP3AKB KABUPATEN JEMBER 272 - 289
Rizqi Ahmad Nurillah
Retno Endah Supeni
Ahmad Izzuddin

PEMETAAN SISTEMATIS TOPIK KINERJA EKONOMI TAHUN 2015-2024 BERDASARKAN ANALISIS BIBLIOMETRIK 290 - 320
Fhirlyadi Aji
Dirvi Surya Abbas

PENGARUH FINANCIAL DISTRESS, LEVERAGE, OPINI AUDIT, AUDIT DELAY TERHADAP NILAI PERUSAHAAN 321 - 334
Sigit Budi Santoso
Dirvi Surya Abbas
Ismi Ramadhani
Indriyani
Syifa Nurkamilah

PROMOSI ONLINE, HARGA, DAN CITA RASA TERHADAP KEPUTUSAN PEMBELIAN PAPA COOKIES 335 - 349
Dina Novita Sari
Ika Purwanti

PENGEMBANGAN IDE INOVASI KRIPIK TAHU KHAS BANGKA DENGAN MENGGUNAKAN PROSES DESIGN THINKING 350 - 365
Feby Febriyani
Heru Wijayanto Aripradono

UJI PERBANDINGAN KARAKTERISTIK PENELITIAN PADA VARIABEL KOMUNIKASI PEMASARAN, DAYA TARIK DAN KEPUTUSAN PEMBELIAN 366 - 378
Meilaty Finthariasari
Zhenyuan Wang
Ari Yunita

DAMPAK IMPLEMENTASI PSAK 71/115 TERHADAP PRAKTIK MANAJEMEN LABA DAN PENGHINDARAN PAJAK 379 - 397
Cinthya Oktaviana Nugroho

Eko Budi Santoso

KEPUASAN DAN LOYALITAS PENGGUNA DALAM DIGITALISASI USAHA JASA BERBASIS PLATFORM DI INDONESIA 398 - 411
Jodi Septiadi Akbar
Ramadhana Aulia Wisdawati

PENGARUH KUALITAS PELAYANAN DAN KERAGAMAN PRODUK TERHADAP KEPUASAN KONSUMEN, MELALUI KEPUTUSAN PEMBELIAN SEBAGAI VARIABLE INTERVENING PADA MINIMARKET SUPERIO SITUBONDO 412 - 441
Devi Tri Wulandari
Theresia Pradiani
Fathorrahman

PERAN STRATEGIS PEMERINTAH DALAM PERTUMBUHAN EKONOMI ISLAM DI INDONESIA BERDASARKAN PERSPEKTIF AL-QUR'AN DAN HADIST: KAJIAN INVESTASI SYARIAH 442 - 454
Fadlia Galib
M. Zaidi Abdad
Nikmatullah

ETIKA DISTRIBUSI KEKAYAAN DALAM PANDANGAN AL-QUR`AN 455 - 468
Yeni Helmalia Putri
M. Zaidi Abdad
Nikmatullah

UPAYA MENSTABILKAN PEREKONOMIAN AKIBAT KRISIS EKONOMI MELALUI ISNTRUMEN ZAKAT 469 - 482
Sa'an Awaludin
M. Zaidi Abdad
Nikmatullah

PERAN EKONOMI ISLAM DALAM UPAYA MENCAPAI KEADILAN PADA ETIKA BISNIS PERSPEKTIF STUDI QUR'AN DAN HADIST EKONOMI 483 - 496
Sandriani
M. Zaidi Abdad
Nikmatullah

ANALISIS KEUNGGULAN KOMPARATIF DAN PENTINGNYA LABEL HALAL PADA PRODUK PALM OIL DI PERDAGANGAN INTERNASIONAL 497 - 510
Meldina Aulia Ananda
Nikmatullah
M. Zaidi Abdad

PENGARUH LINGKUNGAN KERJA, BEBAN KERJA, DAN KERJASAMA TIM TERHADAP KINERJA KARYAWAN PADA PT. CITRA INSAN ANUGERAH DI PALEMBANG 511 - 532
Putri Marsela Wijaya
Ima Andriyani
Ulil Amri
Hisbullah Basri

ANTESEDEN DARI POSITIVE WORD OF MOUTH PADA DESTINASI WISATA DI INDONESIA 533 - 546
Ahmat Mutawali Putra
Aekram Faisal

PENGARUH PENGALAMAN MEREK, KEPERCAYAAN, DAN KEPUASAN DALAM MEMBANGUN LOYALITAS MEREK PADA PRODUK HALAL 547 - 561
Dwi Septi Ariyani
Anton Agus Setyawan

STUDI TENTANG DAMPAK DISIPLIN KERJA, PENGALAMAN PROFESIONAL, DAN KOMPENSASI TERHADAP OPTIMALISASI KINERJA KARYAWAN DOESOEN KAKAO 562 - 577
Ahmad Yusron
Moh. Usman Kurniawan
Neviyani

A COMPREHENSIVE ANALYSIS OF THE DETERMINANTS OF INCOME INEQUALITY OVER THE PAST DECADE IN INDONESIA “PANEL DATA APPROACH” 578 - 588
Suntra Yanti
M. Fikry Hadi
Muhammad Hidayat

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# A COMPREHENSIVE ANALYSIS OF THE DETERMINANTS OF INCOME INEQUALITY OVER THE PAST DECADE IN INDONESIA "PANEL DATA APPROACH"

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***ABSTRACT***

*Income inequality is a serious challenge facing the world, including Indonesia. This study aims to analyze the factors affecting income inequality in Indonesia from 2014 to 2023, using panel data from 34 provinces. The random effect model (REM) regression method assesses the impact of economic, social, and geographic variables on income distribution. The results show that economic growth significantly impacts inequality, while GRDP per capita and domestic investment have a significant negative impact. Factors such as population and education also have a positive effect on inequality, while poverty has no significant effect. The results support the Kuznets Curve hypothesis, which states that inequality increases in the early stages of development, increased equitable investment, and access to education as efforts to reduce income inequality. By promoting inclusive growth this study contributes to a deeper understanding of the dynamics of inequality in Indonesia.*

## INTRODUCTION

Income inequality is a global challenge that threatens economic stability and hinders development. The issue has been prioritized in the 2030 Agenda for Reducing Inequality due to its far-reaching implications for social and economic transformation (Acheampong et al., 2021; Kavya & Shijin, 2020; Vo et al., 2023). Based on data from the *World Inequality Database* for 2023, the distribution of national income taken by the richest 10% of the population in different countries, where red indicates very high inequality (a larger share of income is held by the richest 10% group) and yellow indicates lower inequality. The distribution of income inequality shown in the map below provides a clear picture of the variation in inequality across different regions of the world, which is often linked to structural differences in economies, policies, and social systems.

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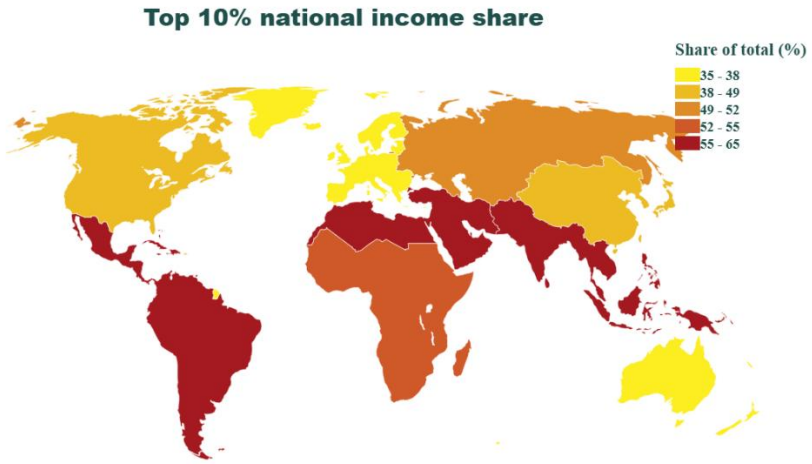


Fig 1 :10% of the Richest Group Holding National Income
Source : *World Inequality Database*

Latin America and some African countries highlighted in red have very high levels of income inequality. Asia also has relatively high levels of income inequality, as seen in several regions, particularly South Asia, Southeast Asia (ASEAN), and the Middle East. ASEAN, a region consisting mostly of developing countries, also faces similar problems. Inequality conditions in ASEAN are still relatively high (Suratman et al., 2022) because the financial system and international trade among countries in the ASEAN region have not been able to provide equal benefits to increase income or reduce inequality, income inequality in ASEAN is a complex and serious issue, especially given the significant gap between high and low-income groups and the large number of people living below the poverty line. Although some countries in the region have experienced improvements in economic growth, income inequality remains a major challenge. Gini index data released that there are large differences in income between different areas and social groups (Anasta & Sylviana, 2024).

In Indonesia, income inequality is still a serious problem that hinders inclusive growth. Based on data from *Badan Pusat Statistik (BPS)*, Indonesia's Gini ratio index has tended to fluctuate over the past 10 years, indicating that income inequality in various provinces is still high despite efforts to accelerate equitably development.

Fig 2 : Indonesia's Gini Ratio Index
Source : (BPS, 2024)

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Income inequality in Indonesia is not only between individuals, but also between regions. Based on the data presented in (Panggarti et al., 2022), it is shown that government spending varies between islands in Indonesia and tends to be concentrated in Java and Sumatra. The difference in spending will have an impact on uneven develompent between regions, which can trigger inequality between regions. This has the potential to worsen social conditions, such as increased poverty and limited economic opportunities in remote areas, which in turn can hinder overall national development.

Previous studies have shown that income inequality in Indonesia is caused by various factors such as differences in education, poverty, wage rates, and investment (Baskoro et al., 2024; Janah, 2022; Maesza et al., 2022; Nursahid & Mintarti, 2018). The Kuznets Curve, which states that inequality often increases in the early stages of development before decreasing at a certain stage, provides an important theoretical basis for understanding the dynamics of income inequality in developing countries such as Indonesia (Ananda & Prabowo, 2021). In additions, factors such as technological change and urbanization also affect inequality by widening the gap between urban and rural areas.

In the past 10 years, the income inequality index in Indonesia has been fluctuating, which indicates that the government's policy in addressing inequality in Indonesia is inappropriate. Tharefore, this study was conducted to look at the decade 2014-2023. This study also uses panel data covering 34 provinces in Indonesia to assess the influence of economic, social and geographic factors on income distribution. Therefore, in understanding these factors. It is expected to provide more appropriate policy recommendations to reduce income inequality in Indonesia and support more inclusive and sustainable development. This study also aims to analyze the extent of Indonesia's position in the Kuznets Curve.

## LITERATURE REVIEW

### Income Inequality

Income Inequality is the unequal distribution of income in society, which affects social welfare, economic development, and sociopolitical stability (Weber, 2024). Inequality is exacerbated by globalization and technological automation, which favor highly skilled worked (Acemoglu & Restrepo, 2019). India, for example, faces a major challenge due to growing economic inequality, which often results in low or no wages for unskilled workers (Akshita Sheoran, 2024). Kuznets theory explains that inequality increases in the early stages of industrialization due to labor migration to urban sectors, but decreases in later stages due to income retribution, inclusive policies, and equitable access to education (Yusuf et al., 2021). To address inequality, retributive policies such as progressive taxation are needed to create a more inclusive system (Weber, 2024). In (Azam & Raza, 2018a) describes the Kuznets Curve as follows.

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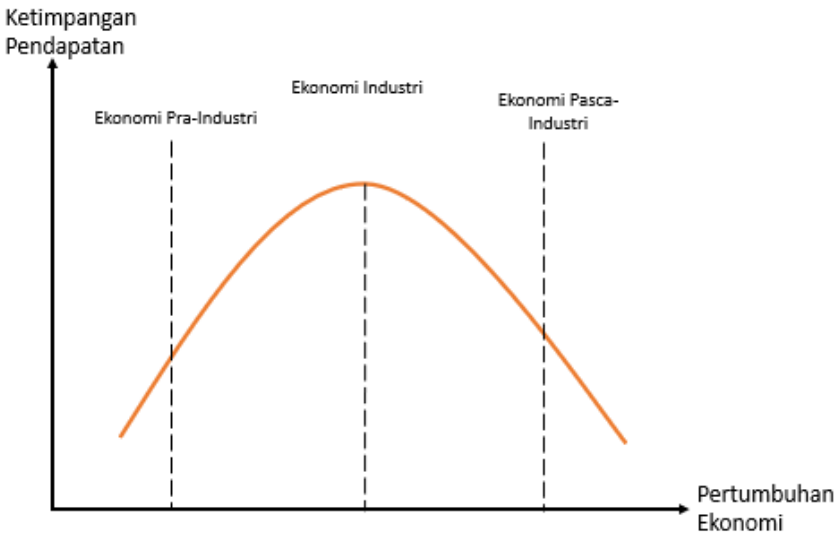


Fig 3: "Inverted U" Kuznets Curve
Source :(Azam & Raza, 2018b)

Empirical studies in Thailand show that the theory does not always apply nationally, but is quite relevant in certain regions such as the North and Northeast (Maneejuk et al., 2021). In the Indonesia context, Kuznets theory can be used to analyze the relationship between economic growth and income inequality.

**Economic Growth**

Economic have long belivied that economic growth solves the problem of inequality and poverty. Early literature dating back to Kuznets (1955) assumsed that sustained economic growth would eventually lead to lower levels of income inequality (Kuznets hypothesis) (Hidayat & Karimi, 2020). Economic growth is often criticized for not always reflecting real living standards (Piętak, 2014). Kuznets' theory suggests that growth can sustainably reduce income inequality (Nunoo et al., 2024). The relationship between economic growth and income inequality is influenced by the stage of development on the Kuznets Curve. If only high-income groups benefit from growth, inequality will increase (Rahmawati et al., 2024). Previous research shows mixed results on the relationship between economic growth and income inequality. In contrast to these findings, another study in Indonesia by (Purusa et al., 2024) found that economic growth has a positive relationship and significant effect on income inequality.

**GRDP Per Capita**

GRDP per capita is the result of GRDP divided by population and the average income of individuals. High GRDP does not always mean high per capita income, depending on the population. An is a measure of the average income of a country's population, calculated by dividing national income by population (Lestari et al., 2024). This indicator has a strong impact on income inequality. Based on the research results of (Ahmad et al., 2024; Lestari et al., 2024), there is a positive and significant relationship between GRDP per capita and income inequality. However, research by (Setiawan et al., 2024) states that GRDP per capita does not affect income inequality in 34 provinces in Indonesia.

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**Population**

Residents are individuals who live in Indonesia for at least 6 months or intend to stay ecen if less than that (Al Aqilah et al., 2024). Population affect inequality betweeen regions, where rapid population growth without economic equalization can increase inequality and reduce per capita income (Chatra et al., 2019). According to the Kuznets Curve theory (1955), income inequality increases in the early stages of economic development due to economic growth and urbanization, but decreases as the economy reaches a more mature stage of development (Lestari et al., 2024). Research by (Purusa et al., 2024) found a negative and significant relationship between population and income inequality, while research by (Lestari et al., 2024) found a positive and significant relationship between the two.

**Education**

Inequality in education also plays an important role in income inequality in India (Akshita Sheoran, 2024). The level of education is an organized long-term prosess of improving the theoretical and conceptual knowledge of the workforce, especially the managerial workforce (Dai et al., 2023). Education play an important role in improving productivity, skills, and quality of human resources, thereby contributing to increasing national income and reducing economic backwardness (Sari et al., 2021). However, unequal education can exacebate inequality, as higher education provides greater earning opportunities. One study finds that educational inequality has a significant impact on income inequality (Lutfiani & Yuniasih, 2021). However, research in Nigeria (Owolabi et al., 2024) finds that education does not have a significant effect on income inequality and considers education to be an inappropriate indicator for studying inequality.

**Poverty**

Poverty is state of economic inability to meet the average community standard of living, characterized by insufficient income to meet basic needs such a food, clothing, and shelter (Dai et al., 2023). People are considered poor if their per capita expenditure is below the poverty line (Al Aqilah et al., 2024). Research by (Demand, 2023; Zulkarnain & Satrianto, 2023) found that poverty level has a positive and significant effect on income inequality. In contrast, research by (Dai et al., 2023) states that poverty has a negative relationship with income inequality but no significant effect.

**Domestic Investment (DI)**

Domestic investment as explained in (DPMPTSP, 2023) is an investment activity business in the territory of the Republic of Indonesia carried out by domestic investors using domestic capital. According to Jhigan (2004) in (Silalahi et al., 2024), the Harrod-Domar growth theory emphasizes that investment plays a key role in economic growth by generating income and expanding production capacity through increashing capital stock. Investment is important for economic development because it supports the sustainability of economic activity, increases production, and absorbs labor (Hartini, 2017). However, investment also has the potential to cause income inequality, especially when it is concentrated in certain regions (Julihanza & Khoirudin, 2023). Investment, both from the private sector (FDI and DI) and the government, promotes regional economic growth, but its uneven distribution can exacerbate interregional inequality. (Demand, 2023) found in his research that investment has a positive and significant effect one income inequality.

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**Regional Minimum Wages**

According to neo-classical economic principles, minimum wage regulation can increase income inequality because it creates a wage floor that raises the value of workers' wages (Al Aqilah et al., 2024). Minimum wages levels affect worker morale, firm productivity, and production costs. While inequality in regional development can lead to improved quality of life, it can also exacerbate income inequality. Minimum wage monitoring is needed to support economic justice and reduce income inequality in Indonesia (Julihanza & Khoirudin, 2023). Differences in people's abilities in terms of the amount of wages and the fulfillment of capital will further increase the income gap (Wijayanti & Putri, 2023). In (Zulkarnain & Satrianto, 2023), wages have a negative and significant relationship with income inequality.

## METHODOLOGY

This research method uses a quantitative appoarch, which is based on the philosophy of positivism as a scientific method that is concrete, empirical, objective, measurable, rational, and systematic (Silalahi et al., 2024). The data used in secondary data sourced from the *Badan Pusat Statistik (BPS).* The following is a description of the variables used in this study.

| | | |
|---|---|---|
| igr | : | Income inequality |
| pdrb | : | Economic Growth |
| lpdrbpk | : | GRDP Per Capita |
| ljp | : | Population |
| aps | : | Education |
| jpm | : | Poverty |
| ldi | : | Domestic Investment |
| ump | : | Regional Minimum Wages |

This study uses a combination of time series methods for 10 years (2014-2023) and cross-section with 34 provinces in Indonesia. The analysis used in this study is panel data analysis, which is data that has both time series characteristics and cross-section (Ariefianto, 2012). The regression model used in panel data analysis is the two-way model, which considers the time effect or includes variables. According to Basuki, the estimation of regression model with panel data can be done through three approaches, namely common effect model (CEM), fixed effect model (FEM) and random effect model (REM) (Rifkhan, 2022). Based on the results of Chow test, Hausman test and Lagranger Multiplier test, REM is selected as the best model. Then, the static equation of the REM model in the book (Ariefianto, 2012) is as follows.

$$Yit = \beta_0 + \beta_1 X_{it1} + \ldots + \beta_k X_{itk} + v_{it}$$

## RESULT AND DISCUSSION

**Selection Of The Best Model**

Based on the Chow test results, it is known that the p-value is 0.00 < 0.05, which means that the FEM model is better than CEM. After that, the Hausman test was conducted to select a model between FEM and REM, the Hausman test results showed a p-value 0f 0.92 > 0.05, which means that the REM is better than FEM. To ensure REM

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is the best choice model, the last test is the Lagranger Model test to determine the model between REM and CEM, the result is a p-value of 0.00 < 0.05, which means that the REM is better than the CEM. The regression results are shown in Table 1.

**Table 1.**
**Summary of Regression Results**

| Variabel | CEM | | | | FEM | | | | REM | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Coef | std. err | t | prob | Coef | std. err | t | prob | Coef | std. err | t | prob |
| pdrb | 4,830 | 1,010 | 4,78 | 0,00 | 3,820 | 1,850 | 2,07 | 0,03 | 3,311 | 1,250 | 2,65 | 0,00 |
| lpdrbk | -0,008 | 0,005 | -1,45 | 0,14 | -0,032 | 0,011 | -2,79 | 0,00 | -0,018 | 0,009 | -1,99 | 0,04 |
| ljp | 0,016 | 0,002 | 5,88 | 0,00 | 0,002 | 0,001 | 1,62 | 0,10 | 0,003 | 0,001 | 2,16 | 0,03 |
| aps | 0,001 | 0,000 | 3,76 | 0,00 | 0,004 | 0,000 | 18,91 | 0,00 | 0,004 | 0,000 | 17,95 | 0,00 |
| jpm | -3,150 | 3,770 | -0,84 | 0,40 | 0,000 | 9.740 | 1,70 | 0,09 | 4,865 | 5,540 | 0,88 | 0,38 |
| ldi | -0,017 | 0,001 | -6,21 | 0,00 | -0,002 | 0,000 | -2,28 | 0,02 | -0,002 | 0,001 | -2,88 | 0,00 |
| ump | 9.210 | 3,990 | 0,23 | 0,81 | -2,044 | 2,920 | -7.00 | 0,00 | -2,036 | 2,690 | -7.58 | 0,00 |
| cons | 0,292 | 0,065 | 4,44 | 0,00 | 0,381 | 0,120 | 3,15 | 0,00 | 0,256 | 0,096 | 2,67 | 0,00 |
| **$R^2$** | **0,294** | | | | **0,610** | | | | **0,605** | | | |
| **F** | **0,000** | | | | **0,000** | | | | **0,000** | | | |
| | **Uji Chow = 0,000 < 0,05 → FEM** | | | | | | **Uji Hausman = 0,922 > 0,05 → REM** | | | | | |
| | **Uji Lagranger Multiplier = 0,000 < 0,05 → REM** | | | | | | | | | | | |

*Source: Results of Data Processing (STATA 17)*

**Legend: * p<0.05; ** p<0.01; *** p<0.001**

**Panel Data Regression Result**

To identify the factors affecting income inequality among provinces in Indonesia, panel data regression using the REM approach is used. A summary of the regression results is shown in Table 1. Based on the result, the regression equation is as follows.

$$igr = 0{,}256 + 3{,}311\ pdrb - 0{,}018\ lpdrbpk + 0{,}003\ ljp + 0{,}004\ aps + 4{,}865\ jpm - 0{,}002\ ldi_log - 2{,}036\ ump_log$$

Based on the result of regression analysis shown in Table 1, the $R^2$ value is 0.605 indicating that the effect of economic growth, GRDP per capita, population, education, poverty, domestic investment and regional minimum wages on income inequality is 60,5 %, the rest is influenced by other variables outside this study. The result of the F-test in this study is 0.00 as seen from the prob value, which means that all independent variables have a simultaneous effect on income inequality. For individual analysis, the t-test results show the relationship of each independent variable with the dependent variable.

Economic growth has a significant positive effect on income inequality with a coefficient of 3.311 and a prob value of 0.00 < 0.05. this result is consistent with the research (Purusa et al., 2024) that shows a unidirectional relationship between economic growth and income inequality in Indonesia. These results indicate that Indonesia is in the early to middle stage of the Kuznets Curve, where the higher the economic growth, the income inequality. Growth is mostly felt by developed regions, such as urban areas, while underdeveloped regions, especially rural areas, have not benefited significantly. Therefore, policies are needed to equalize the economic benefits.

GRDP per capita has a significant negative effect on income inequality with a coefficient of -0.018 and a prob value of 0.04 < 0.05, which means that an increase in GRDP per capita will reduce income inequality. These results are different from the findings of (Sari et al., 2021) and (Lestari et al., 2024) which show a significant positive effect on income inequality with a

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coefficient value of 0.003 and a prob value of 0.03 < 0.05. This result is consistent with the research (Lutfiani & Yuniasih, 2021) which indicates that an increase in population is followed by an increase in income inequality. Education also has a positive and significant effect on income inequality, which can be seen in the coefficient of 0.004 and a prob value of 0.00 < 0.05.

Poverty has no effect on income inequality in this study. This result is consistent with the findings of (Dai et al., 2023) who state that the effect of poverty on income inequality is not significant. This finding may occur because social assistance, which is a government program to eradicate poverty, has been proven to reduce poverty (Lindiasari & Ramadhani, 2019). Social assistance can reduce inflation because people's purchasing power continues to improve due to the social assistance program, which is distributed in cash and in-kind (Agus Triono et al., 2023). Social assistance plays a role in reducing poverty by providing a safety net for vulnerable groups, thus covering the direct impact of poverty on income inequality.

Domestic investment (DI) has a significant negative effect on income inequality with a coefficient of 0.002 and a prob value of 0.02 < 0.05. this means that an increase in domestic investment can reduce income inequality in Indonesia. This result is different from (Demand, 2023) who found a positive relationship between the two. Finally, regional minimum wage also has a significant negative that a decrease in minimum wages tends to increase income inequality. This result is consistent with the research of (Zulkarnain & Satrianto, 2023). This suggests that wages are one of the factor affecting income inequality in Indonesia.

## CONCLUSIONS

Income inequality is a problem faced globally, including Indonesia. Factors such as economic growth, GRDP per capita, population, education, domestic investment, and regional minimum wages affect income distribution among regions. Based on the analysis, economic growth has a significant positive relationship with income inequality. The higher the economic growth, the more income inequality tends to increase. The benefits of growth are left more in urban areas than in rural areas, supporting the Kuznets Curve hypothesis that inequality tends to increase in the early stages of development. Minimum wage and education, while the minimum wage helps reduce inequality, unequal education can reduce its effectiveness, as workers with low education still have limited access to high-paying jobs. Domestic investment and GRDP per capita, both play a key role in reducing inequality by expanding economic opportunities and distributing economic benefits more equitably. This conclusion confirm the importance of policies that support equitable development, equitable investment, and improved access to education to reduce income inequality and achieve inclusive and sustainable economic development in Indonesia.

## SUGGESTION

Overall, the results of this study suggest that various factors, both those that increase and those that reduce income inequality, need to be considered when formulating policies to achieve greater economic equity in Indonesia. This study could examine the impact of urbanization on income inequality in Indonesia, especially in regions with high urbanization rates such as Java and Sumatra. With the finding that minimum wage has a negative relationship with inequality, further research can examine the optimal boundary of minimum wage policy to effectively reduce inequality. Using a one-period time series, this study can test whether Indonesia has moved towards reducing inequality according to the Kuznets Curve pattern. It is suggested for future research to try new variables such

as social assistance and inflation to see the effect of poverty on income inequality, and further researchers can try to use correlation analysis to analyze the relationship between these new variables.

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