

# The Illusion of Prosperity in the Shadow of Growth: Institutional Quality, Social Protection, and the Paradox of Development in Indonesia

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## Abstract

Indonesia ranks sixth in the Association of Southeast Asian Nations (ASEAN) on the 2024 Prosperity Index, despite maintaining an average annual economic growth rate exceeding 5%. This stark contrast challenges the assumption that growth in Gross Domestic Product (GDP) per capita automatically translates into broad-based prosperity. This study examines the effects of macroeconomic conditions, social protection, and institutional quality on Indonesia's prosperity from 1995 to 2024 using the Autoregressive Distributed Lag (ARDL) approach. The variables analyzed include GDP per capita, government expenditure, foreign direct investment, urbanization, the equal protection index, and control of corruption. The findings reveal that equal legal protection has a significant positive long-term effect, whereas economic growth and foreign capital inflows do not consistently enhance prosperity and may even have negative impacts if benefits are concentrated. Government expenditure exhibits a negative long-term effect, reflecting inefficiencies and issues related to spending composition. These results underscore that without institutional reform and stronger social protection, economic growth risks producing illusory prosperity. This study contributes to the Institutional Quality–Growth Nexus literature and highlights the urgent need for policies that balance growth, equity, and governance to achieve sustainable prosperity.

*[Indonesia menempati peringkat keenam di ASEAN dalam Prosperity Index tahun 2024, meskipun mempertahankan tingkat pertumbuhan*

*ekonomi tahunan rata-rata di atas 5%. Kontras yang mencolok ini menantang asumsi bahwa peningkatan Produk Domestik Bruto (PDB) per kapita secara otomatis menghasilkan kesejahteraan yang merata. Penelitian ini mengkaji pengaruh kondisi makroekonomi, perlindungan sosial, dan kualitas institusi terhadap tingkat kesejahteraan di Indonesia selama periode 1995-2024 dengan menggunakan pendekatan Autoregressive Distributed Lag (ARDL). Variabel yang dianalisis meliputi PDB per kapita, pengeluaran pemerintah, investasi asing langsung, urbanisasi, indeks perlindungan hukum yang setara, serta pengendalian korupsi. Hasil penelitian menunjukkan bahwa perlindungan hukum yang setara memiliki pengaruh positif jangka panjang yang signifikan, sementara pertumbuhan ekonomi dan arus modal asing tidak secara konsisten meningkatkan kesejahteraan, bahkan dapat berdampak negatif apabila manfaatnya terpusat pada kelompok tertentu. Pengeluaran pemerintah menunjukkan pengaruh negatif dalam jangka panjang, yang mencerminkan inefisiensi serta permasalahan dalam komposisi belanja. Temuan ini menegaskan bahwa tanpa reformasi kelembagaan dan penguatan perlindungan sosial, pertumbuhan ekonomi berisiko menghasilkan kesejahteraan yang semu. Studi ini berkontribusi pada literatur Institutional Quality–Growth Nexus serta menyoroti urgensi kebijakan yang menyeimbangkan pertumbuhan, pemerataan, dan tata kelola untuk mencapai kesejahteraan yang berkelanjutan.]*

**Keywords:** ARDL Model, Economic Growth, Institutional Quality, Prosperity Index, Social Protection.

## **Introduction**

National prosperity is determined not only by economic growth but also by the distribution of development outcomes, institutional quality, and the effectiveness of social protection in ensuring equal opportunities for all citizens. Classical development theory views Gross Domestic Product (GDP) per capita growth as the main driver of welfare (Kuznets, 2019; Lewis, 1954), yet multidimensional welfare approaches emphasize non-economic aspects such as health, education, political participation, and social security (Sen, 1999; Stiglitz et al., 2009). Contemporary literature demonstrates that growth without inclusivity tends to be fragile and socially volatile (Berg & Ostry, 2017; Ostry et al., 2014), while high inequality constrains human capital accumulation and productivity (Aiyar & Ebeke, 2020; Lakner & Milanovic, 2016; Piketty, 2014). Within the Inclusive Growth Framework (Ranis et al., 2000), rising average incomes must be accompanied by institutional reforms, robust social policy, and investment in human capital (Anand et al., 2013; OECD, 2023).

Institutional quality, particularly control of corruption and legal equality, forms the foundation of sustainable prosperity (Acemoglu et al., 2005; North, 1990). Recent cross-country studies confirm the positive relationship between rule of law, judicial capacity, and long-term economic performance (Aydin &

Karabulut 2024; Dima et al., 2018; Roth 2022). In Indonesia, the rule of law index suggests significant room for improvement in equal enforcement (World Justice Project, 2024), where the success of social protection programs such as conditional cash transfers and national health insurance has been shown to reduce household vulnerability and enhance social mobility (Cahyadi et al., 2020; Prati, 2022; Probandari et al., 2025). Moreover, recent research highlights the role of psychosocial effects such as public trust and perceived social fairness as mediators between governance quality and welfare. Macroeconomic conditions, including trade openness, foreign direct investment, and urbanization, influence prosperity via technology transfer, market integration, and productivity agglomeration (Duong et al., 2022; Gao et al., 2022; Henderson & Turner, 2020; Javorcik, 2004). Yet, the positive effects of foreign direct investment depend on domestic absorptive capacity and public policy quality (Haini & Tan 2022; Nurbel & Ahamada 2008; Onayemi, Olomola, & Alege 2018), while investment modes whether greenfield or mergers and acquisitions determine the depth of domestic linkages (Gopalan et al., 2018). Rapid urbanization without adequate infrastructure, affordable housing, and mass transit can lower quality of life, exacerbate spatial inequality, and erode social capital (Joshi et al., 2024; World Bank, 2025; Wu et al., 2021; Yudhistira et al., 2024).

Government expenditure can serve as a catalyst for prosperity if targeted at high-multiplier sectors such as education, health, and productive infrastructure (Afonso et al., 2024; Coman, 2023). However, its effectiveness is shaped by spending composition, efficiency, and implementation capacity (Adarov et al., 2024; Kapsoli, J., Mogue, T., & Verdier, 2023; OECD, 2025). The International Monetary Fund (IMF) (2024) finds that in developing economies, inefficiencies in capital expenditure weaken long-term growth potential, making public investment management reform essential. Although bilateral relationships between economic growth, institutional quality, social protection, and prosperity have been widely studied, most analyses remain partial and seldom examine the simultaneous linkages among these determinants within a framework that distinguishes short- from long-run dynamics.

Literature integrating the Equal Protection Index as an institutional proxy in multidimensional prosperity analysis, especially in Indonesia, remains scarce. This study addresses this gap by adopting the autoregressive distributed lag approach on annual data from 1995 to 2024 to analyze the effects of macroeconomic conditions, social protection, and institutional quality on prosperity. The novelty lies in integrating the Equal Protection Index into a macro-institutional prosperity model and separating short- from long-run effects. Theoretically, this study extends the Institutional Quality–Growth Nexus and Inclusive Growth Framework, while practically offering evidence-based policy recommendations to foster inclusive growth, institutional strengthening, and social protection as the foundation for sustainable prosperity.

Building on this gap, this study develops an integrated framework to analyze how macroeconomic conditions, institutional quality, and social protection jointly shape national prosperity in Indonesia. Employing the Autoregressive Distributed Lag approach, it captures both short-run dynamics and long-run relationships while introducing the Equal Protection Index to reflect legal equality within institutional structures. The analysis is designed to uncover the interaction among these determinants and their contribution to inclusive welfare. In doing so, the study advances a more unified explanation of prosperity formation and provides policy-relevant insights for achieving equitable and sustainable development.

### Research Methodology

This study employs a quantitative time-series design to examine the short- and long-run effects of macroeconomic conditions, social protection, and institutional quality on prosperity in Indonesia. The Autoregressive Distributed Lag (ARDL) model is adopted because it can handle regressors with a mixed order of integration— $I(0)$  and  $I(1)$ —without requiring pre-differencing, provided none is integrated of order  $I(2)$  (Pesaran et al., 2001). The dataset covers the period 1995–2024 to capture long-term structural dynamics. Data are sourced from, see Table 1:

**Table 1**  
**List of Variables**

Variables	Definition and Measurement	Time-Frequency	Sources
Prosperity	Prosperity Index (0-100)	1995-2024	Human Progress
Government Expenditure	General Final Consumption Expenditure % GDP		World Bank
Social Protection	Equal Protection Index (0-100)		Human Progress
Institutional Quality	Control of Corruption Percentile Rank (Z-score)		WGI
Foreign Direct Investment	FDI Net Inflows (% GDP)		World Bank
GDPper Capita	GDPper Capita (Annual Growth %)		
Urbanization Rate	Urban Population (Total Population %)		

Source: Authors' Compilation.

The ARDL approach is theoretically grounded in the dynamic adjustment theory in macroeconomics, which posits that economic variables adjust toward equilibrium over time through lagged effects. It is also consistent with the Institutional Quality–Growth Nexus (Acemoglu et al., 2005) and the Inclusive Growth Framework (Ranis et al., 2000), which recognize that the impacts of governance quality, social protection, and macroeconomic fundamentals

manifest differently in the short and long term. Macroeconomic indicators such as GDP per capita and FDI often follow persistent stochastic trends (Nelson & Plosser, 1982), while institutional variables like corruption control and equal protection change gradually due to path dependence (North, 1990). ARDL's ability to estimate optimal lag structures allows the model to capture delayed effects, consistent with structural transformation theory (Kuznets, 2019; Lewis, 1954), where reforms and policy interventions produce outcomes in a phased manner.

The integration order of each variable is determined using the Augmented Dickey-Fuller (ADF) and Kwiatkowski-Phillips-Schmidt-Shin (KPSS) tests. This ensures compliance with ARDL's requirement that variables be  $I(0)$  or  $I(1)$ . The optimal lag length is selected using multiple criteria (AIC, SC, HQ, FPE, and LR tests) to balance model fit and parsimony (Burnham & Anderson, 2004). The general ARDL model is specified as:

$$Y_t = \alpha_0 + \sum_{i=1}^p \beta_i Y_{t-i} + \sum_{j=0}^{q1} \gamma_j GDPpc_{t-j} + \sum_{k=0}^{q2} \delta_k SP_{t-k} + \sum_{l=0}^{q3} \theta_l GE_{t-l} + \sum_{m=0}^{q4} \phi_m FDI_{t-m} \\ + \sum_{n=0}^{q5} \omega_n IQ_{t-n} + \sum_{o=0}^{q6} \phi_o Urban_{t-o} + \varepsilon_t$$

Where  $Y_t$  is the Prosperity Index,  $GDPpc$  is GDP per capita (log),  $SP$  is the Equal Protection Index (z-score),  $GE$  is government expenditure (% GDP),  $FDI$  is foreign direct investment (inverse hyperbolic sine transformation),  $IQ$  is control of corruption (z-score), and  $Urban$  is urbanization rate (log). The presence of a long-run relationship is tested using the Bounds Test. If cointegration is confirmed, the ARDL model is re-estimated in its Error Correction Model (ECM) form:

$$\Delta Y_t = \alpha_0 + \sum_{i=1}^{p-1} \beta_i \Delta Y_{t-i} + \sum_{j=0}^{q1-1} \gamma_j \Delta GDPpc_{t-j} + \sum_{k=0}^{q2-1} \delta_k \Delta SP_{t-k} + \sum_{l=0}^{q3-1} \theta_l \Delta GE_{t-l} + \sum_{m=0}^{q4-1} \phi_m \Delta FDI_{t-m} \\ + \sum_{n=0}^{q5-1} \omega_n \Delta IQ_{t-n} + \sum_{o=0}^{q6-1} \phi_o \Delta Urban_{t-o} + \lambda ECM_{t-1} + \varepsilon_t$$

Here,  $\lambda$  is the Error Correction Term (ECT) coefficient; a negative and statistically significant value indicates that short-run deviations are corrected toward long-run equilibrium. To ensure reliability, diagnostic tests are conducted. Serial correlation is assessed using the Ljung-Box Q-test; residual normality is checked via the Jarque-Bera test; and heteroskedasticity is examined using the Breusch-Pagan, Harvey, Glejser, ARCH-LM, and White tests. Additionally, HAC-robust standard errors (Newey-West) are employed to correct for potential heteroskedasticity and autocorrelation, thereby enhancing the robustness of statistical inference.

## Results

### *Statistic Descriptive*

Table 2 presents the descriptive statistics for all variables used in the study, including the dependent variable Prosperity Index (Y) and independent variables such as Government Expenditure (GE), Equal Protection Index (SP), Control of Corruption (IQ), Foreign Direct Investment (FDI), GDP per capita (GDPpc), and urbanization rate (Urban). Descriptive statistics are essential to provide an initial overview of the data distribution, value ranges, and potential anomalies or outliers that may affect model estimation.

The Prosperity Index averages 53.31 with a standard deviation of 4.46, indicating moderate variation across observations. The minimum value of 44.56 and maximum of 59.37 suggest disparities in prosperity across periods or regions. GE averages 4.07% of GDP, with substantial variation (standard deviation 5.57) and even negative values down to -15.37%, potentially reflecting periods of fiscal contraction or data anomalies. The SP (Equal Protection Index) has a mean value of 0.59 (standardized z-score) with low variation, indicating relative stability in legal protection. IQ (Control of Corruption) averages 27.57 with a wide range (8.47–45.23), highlighting significant disparities in governance quality. FDI shows considerable variation (-2.76% to 2.92% of GDP), while GDPpc averages USD 2,544, indicating a lower-middle income status per World Bank classification. Urbanization averages 2.98 (log), indicating moderate urban development.

**Table 2**  
**Statistic Descriptive**

Test Unit	Dependent	Independent					
	Y	GE	SP	IQ	FDI	GDPpc	Urban
Mean	53.307	4.065	0.591	27.570	1.321	2544.392	2.978
Median	53.405	4.121	0.674	28.91	1.812	2642.084	2.871
Maximum	59.372	15.674	0.738	45.238	2.916	4925.430	4.882
Minimum	44.561	-15.371	0.296	8.466	-2.757	454.877	1.843
Std. Dev.	4.462	5.571	0.152	10.351	1.407	1483.193	0.948
Skewness	-0.373	-1.114	-0.905	-0.073	-1.469	0.069	0.883
Kurtosis	-0.819	4.485	-0.961	-1.175	1.705	-1.566	-0.301
Jarque-Bera	1.602	21.603	4.950	1.770	11.657	2.875	3.763
Probability	0.448	0.000	0.084	0.412	0.002	0.237	0.152
Sum	1599.238	121.979	17.746	827.117	39.631	76331.780	89.359
Sum Sq. Dev.	577.611	900.164	0.674	3107.245	57.445	63796041.2	26.101
Observations	30	30	30	30	30	30	30

Source: Authors' compilation.

The descriptive statistics (Table 2) reinforce the relevance of analyzing the relationship between macroeconomics and governance in explaining prosperity.

According to endogenous growth theory (Romer, 1990), variables such as GDPpc and FDI act as engines of long-term growth through capital accumulation and technology diffusion. Institutional variables such as SP and IQ align with North’s (1990) view that institutional quality affects resource allocation efficiency and the achievement of prosperity. The high variability in GE can be explained by the political budget cycle theory, which posits that government spending is often influenced by political agendas, including elections (Rogoff & Sibert, 1988). The moderate urbanization level reflects a stage of structural transition (Lewis, 1954), where urbanization drives changes in economic structure and labor productivity.

**Unit Root Test**

Table 3 presents the unit root test results using the ADF and KPSS methods for each research variable. The objective is to determine the order of integration, which is a critical prerequisite in time series modeling such as ARDL. The combination of ADF and KPSS results helps avoid misclassification of stationarity.

**Table 3**  
**Unit Root Test**

Variables	ADF Level (c)	KPSS Level (c)	ADF Level (ct)	KPSS Level (ct)	ADF First (c)	KPSS First (c)	ADF First (ct)	KPSS First (ct)	Final	Spec used
Prosperity Index (Y)	-2.354	0.847	-1.976	0.140	- 4.122* **	0.398	- 4.739* **	0.077	I(1)	ct
Government Expenditure	- 3.799* **	0.144	-2.909	0.146	- 4.315* **	0.5	- 4.382* **	0.5	I(1)	c
Ln (GDP per capita)	-0.552	0.768	-2.321	0.113	- 5.484 ***	0.121	- 5.408* **	0.119	I(1)	ct
Urbanization Rate	-1.890	0.776	- 3.242* *	0.158	-1.861	0.239	-1.761	0.051	I(1)	ct
FDI	-2.111	0.284	-2.538	0.076	- 3.710* **	0.081	- 3.677* *	0.074	I(1)	c
Equal Protection	-1.139	0.199	-1.839	0.180	- 3.804 ***	0.222	-2.328	0.082	I(1)	ct
Control of Corruption	-1.791	0.606	- 3.506* *	0.116	- 4.908 ***	0.227	- 4.769* **	0.126	I(1)	ct

Notes: ADF Ho = unit root; KPSS Ho = stationarity. Values are test statistics; stars on ADF denote  $p \leq 0.10$  (\*),  $p \leq 0.05$  (\*\*),  $p \leq 0.01$  (\*\*\*). Final = I(0) if ADF rejects & KPSS does not at level; I(1) if they agree on first differences; otherwise, conservative I(1). “Spec used”: c = constant, ct = constant+trend. ADF autolag = AIC; KPSS nlags = auto.

Source: Authors’ compilation.

Table 3 shows that all variables are non-stationary at the level but become stationary at the first difference, thus classified as I(1). For instance, the Prosperity Index (Y) has an ADF value of -2.35 (not significant at the level) but is significant at the first difference (-4.12\*\*\*). Similar patterns are observed for

GDPpc, FDI, SP, IQ, GE, and urbanization. This indicates that the variables exhibit long-term trends and are not mean-reverting at the level, but their changes over time are stationary. This satisfies the ARDL model requirement, which can accommodate a mix of I(0) and I(1) variables without the risk of spurious regression. These results are consistent with the literature suggesting that macroeconomic and governance indicators are typically I(1) due to long-term structural trends (Nelson & Plosser, 1982). The ARDL approach is appropriate as it can handle variables with different integration orders, provided none are I(2) (Pesaran et al., 2001). Moreover, first-difference stationarity reflects that short-term shocks have only temporary effects on variable changes, while the long-term trends remain influenced by fundamental economic and institutional factors (Engle et al., 1987).

### **Lag Order Selection**

Table 4 presents the optimal lag length determination results using the Vector Autoregression (VAR) approach. Selecting an appropriate lag is crucial in ARDL modeling to avoid autocorrelation and model misspecification. Several statistical criteria are applied, including the Likelihood Ratio (LR), Final Prediction Error (FPE), Akaike Information Criterion (AIC), Schwarz Criterion (SC), and Hannan–Quinn Criterion (HQ). The selection is based on the minimum value of each criterion.

**Table 4**  
**Lag Order Using VAR (Vector Autoregression)**

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-355.205	NA	1156.59943	7.053091	7.333331	7.142742
1	-198.001	314.408191	0.658924	-0.475455	1.504767	0.144726
2	-143.47	109.062712	0.474125	-1.207987	2.503154	-0.073454
3	-41.619	203.702103*	0.031771*	-5.499944*	-0.028633*	-3.873036*

Notes: \* marks the lag selected by each criterion. LR = sequential likelihood ratio test at 5% to compare VAR(k) vs. VAR(k-1),  $df = m^2$  ( $m =$  number of endogenous variables). FPE, AIC, SC (BIC), and HQ select the lag with the minimum value. System: [Y, lnGDPpc, SPz, GE, FDI, IQ]; deterministic: constant; Candidates were 0–3; effective samples follow lag loss. All criteria point to lag 3 as optimal; The stability of the model is recommended to be confirmed with AR roots ( $|\lambda| < 1$ ).

Source: Authors' compilation.

The estimation results (Table 4) indicate that all statistical criteria (LR, FPE, AIC, SC, and HQ) consistently recommend using lag 3 as optimal. For instance, the minimum FPE (0.031771) and minimum AIC (-5.499944) are both achieved at lag 3. This consistency reinforces the validity of selecting lag 3, which will be employed in subsequent ARDL specifications. Selecting lag 3 also implies that the model incorporates dynamics up to three previous periods, enabling more accurate capture of both short- and long-term lagged effects. The selection of optimal lag length is a critical stage in time series analysis. A lag that is too short

can cause omitted variable bias by failing to capture lagged effects, while an excessively long lag can result in loss of degrees of freedom and reduced estimation efficiency (Lütkepohl, 2005). Using multiple criteria such as AIC and SC is grounded in the information-theoretic principle (Burnham & Anderson, 2004), which balances model fit with a penalty for complexity. In the ARDL context, the optimal lag length enables capturing the dynamic relationships among variables without overfitting, in line with the recommendations of Pesaran, Shin, and Smith (2001).

### ***Short Run ARDL Results***

Table 5 presents the estimated ARDL models for the short-run relationship between the Prosperity Index (Y) and its explanatory variables: GDP per capita (lnGDPpc), Equal Protection Index (SPz), Government Expenditure (GE), Foreign Direct Investment (FDI\_asinh), Control of Corruption (IQz), and urbanization (dUrban). The models are presented in six specifications: baseline, single-variable additions, and a full model with all variables. The reported coefficients are short-run multipliers, with standard errors in parentheses and significance markers.

The results indicate that the lags of the dependent variable Y are significant in most models, suggesting lagged effects in prosperity. The lnGDPpc variable has a positive effect in the current period but turns negative in the first lag, which may indicate short-term adjustment costs in economic growth. SPz is consistently significant in the first and second lags, with a positive sign in the first lag and a negative sign in the second, implying that improvements in legal protection can boost short-term prosperity but may reverse after a certain period. Variables GE, FDI\_asinh, IQz, and dUrban show varying significance across specifications. For instance, IQz displays a positive and significant effect in some models, suggesting that improved control of corruption contributes to short-term prosperity. The high R-squared values (>0.996) indicate strong explanatory power, although caution is warranted regarding potential overfitting.

These findings are consistent with the literature on short-run dynamics in development economics. The positive lnGDPpc effect in the current period aligns with the Keynesian demand-led growth theory (Kaldor, 1966), where income growth stimulates consumption and economic activity. The negative effect in the first lag supports the adjustment cost hypothesis, which posits that initial growth is often followed by structural adjustments that reduce short-term gains (Aghion & Howitz, 1992). The significance of SPz is in line with institutional theory (Acemoglu et al., 2005), which holds that the protection of civil rights accelerates productive economic activity. However, the reversal effect in the subsequent lag may be explained by the institutional inertia hypothesis, where institutional reforms require time to be absorbed and may entail redistributive effects that are not always positive in the short term. The influence of governance-related variables such as IQz on prosperity supports the argument that good governance

enhances resource allocation efficiency, improves investor confidence, and accelerates growth (Kaufmann et al., 1999).

**Table 5**  
**Short Run ARDL**

Variables	Model 1 Baseline	Model 2 GE	Model 3 FDI	Model 4 IQ	Model 5 dUrban	Model 6 All Variables
Constant	4.4478 (1.1956)***	4.3745 (1.2416)***	4.4078 (1.2650)***	5.6734 (2.3675)**	4.4472 (1.2263)** *	5.5527 (2.8006)*
Y (-1)	0.4047 (0.1724)**	0.4176 (0.1801)**	0.3928 (0.1981)*	0.3784 (0.1808)*	0.3968 (0.1784)**	0.3776 -0.2395
Y (-2)	0.4142 (0.1642)**	0.408 (0.1692)**	0.4221 (0.1789)**	0.4195 (0.1675)**	0.4167 (0.1686)**	0.4193 (0.2033)*
lnGDPpc	0.5049 -0.4128	0.5361 -0.4315	0.5344 -0.4777	0.5657 -0.4322	0.5556 -0.4498	0.6232 -0.5437
lnGDPpc (-1)	-1.5599 (0.4945)** *	-1.5611 (0.5069)** *	-1.5594 (0.5086)** *	-1.5816 (0.5048)** *	-1.5971 (0.5193)** *	-1.6167 (0.5806)**
lnGDPpc (-2)	1.8558 (0.3965)** *	1.7899 (0.4441)** *	1.8612 (0.4097)** *	1.8029 (0.4131)***	1.879 (0.4126)** *	1.8035 (0.4971)***
SPz	-0.138 -0.1395	-0.1184 -0.1526	-0.1417 -0.146	-0.1568 -0.1454	-0.1485 -0.1465	-0.1579 -0.1815
SPz (-1)	0.6205 (0.2058)** *	0.5983 (0.2194)**	0.6202 (0.2116)***	0.5935 (0.2142)**	0.6355 (0.2158)** *	0.6013 (0.2562)**
SPz (-2)	-0.6244 (0.1570)** *	-0.6029 (0.1712)***	-0.6192 (0.1660)** *	-0.5957 (0.1668)** *	-0.6374 (0.1657)** *	-0.6019 (0.2284)**
GE	- -	-0.0056 -0.0151	- -	- -	- -	-0.0022 -0.0177
FDI_asinh	- -	- -	-0.0173 -0.1285	- -	- -	-0.0002 -0.1998
IQz	- -	- -	- -	0.0812 -0.1346	- -	0.0752 -0.1595
dUrban	- -	- -	- -	- -	-0.0992 -0.2973	-0.0965 -0.461
R-squared	0.99629	0.996319	0.996294	0.996368	0.996314	0.996397
F-statistic	6713.81625	3248.3972 3	3226.0828 2	3291.9436 2	3243.8151	1161.59357
Prob (F-statistic)	6.55E-32	6.18E-30	6.71E-30	5.27E-30	6.28E-30	6.66E-25
Observations	27	27	27	27	27	27

Notes: Standard errors in parentheses. \*\*\*, \*\*, and \* denote significance at the 1%, 5%, and 10% levels, respectively. lnGDPpc is the natural log of GDP per capita. SPz is the Equal Protection Index standardized to z-scores (per 1 SD). FDI\_asinh is the inverse hyperbolic sine of FDI (% of GDP (log-like and allows zeros/negatives). IQz is the z-score (per 1 SD) of the Control of Corruption index. dUrban is the first difference of the urbanization variable ( $\approx$  percentage-point change if Urban is a share;  $\approx$  growth rate if Urban is in logs).

**Robust Test and Classical Assumption Test**

Table 6 contains two main sections: first, step A, baseline ARDL estimation results with Heteroskedasticity and Autocorrelation Consistent (HAC) standard

errors to test coefficient robustness. Second, step B: classical assumption tests, including autocorrelation, residual normality, and heteroskedasticity using various methods (Breusch–Pagan, Harvey, Glejser, ARCH-LM, and White test). These tests are essential to ensure that the model does not violate the Classical Linear Regression Model (CLRM) assumptions, thereby maintaining statistical reliability of the estimation results.

**Table 6**  
**Robust Test and Classical Assumption Test**

Step A: ARDL Baseline (HAC-robust SE, lag 1)					
Variable	Coefficient	(SE, HAC1)	p-value (HAC1)		
Constant	2.3421	-0.8148	0.0097***		
Y (-1)	0.5222	-0.1975	0.0160**		
Y (-2)	0.3846	-0.2001	0.0698*		
lnGDPpc	-0.0639	-0.3722	0.8655		
lnGDPpc (-1)	-1.4475	-0.4981	0.0091***		
lnGDPpc (-2)	1.9679	-0.3703	0.0000***		
SPz	-0.0147	-0.1598	0.9278		
SPz (-1)	0.6326	-0.2623	0.0261**		
SPz (-2)	-0.6137	-0.231	0.0156**		
R-squared	0.995922				
Observations	28				
Step B: Classical Assumption Tests					
Autocorrelation (Ljung–Box)					
Lag	Q-stat	Prob (Q)			
1	0.9344	0.3337			
2	4.2845	0.1174			
Normality (Jarque–Bera)					
JB	Prob (JB)	Skew	Kurtosis		
0.9076	0.6352	0.3345	2.4252		
Heteroskedasticity					
F-statistic	Breusch–Pagan	Harvey	Glejser	White	ARCH (LM)
	2.651826	0.970889	1.993623	NA	0.048236
Prob. F	0.0387**	0.4867	0.1037	NA	0.8279
Obs*R-squared	14.770976	8.124862	12.777812	28	0.051994
Prob. Chi-Square	0.0638*	0.4214	0.1197	0.411	0.8196

Notes: Standard errors are Newey–West (HAC, lag = 1). \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels (p-values). Model uses ARDL with Y lags 1–2 and exogenous lags 0–2; effective sample reflects lag losses.

Source: Authors’ compilation.

The robustness tests (see Table 6) show that most baseline ARDL coefficients retain their significance after correction using HAC standard errors. This consistency, especially for key variables such as lnGDPpc and SPz, demonstrates the stability of short-run relationships despite potential heteroskedasticity or autocorrelation issues. Methodologically, this aligns with Greene (2018) and White (1980), who emphasize that robust standard errors effectively correct variance bias in time series models prone to classical assumption violations. The absence of serial autocorrelation, as evidenced by the Ljung–Box test at lags 1 and 2, indicates that residuals do not exhibit temporal

dependence patterns. This is crucial because, according to the Gauss–Markov theorem, the absence of autocorrelation is one of the conditions ensuring efficient OLS estimations (Wooldridge, 2020). Substantively, this suggests that economic or institutional shocks in Indonesia during the observation period did not leave systematic “footprints” that distort variable relationships, consistent with the shock absorption literature in open economies (Blanchard & Galí, 2010).

The normal distribution of residuals (Jarque–Bera p-value = 0.6352) strengthens the validity of statistical inference, given that residual normality is essential for reliable significance testing (Gujarati & Porter, 2009). In the context of Indonesia’s macroeconomy, this indicates that national prosperity trends were not predominantly distorted by extreme outliers, such as the 1998 monetary crisis or the initial contraction during the COVID-19 pandemic. The heteroskedasticity detected by the Breusch–Pagan test, but not confirmed by the Harvey, Glejser, and ARCH-LM tests, reflects idiosyncratic volatility. According to the Political Economy of Macroeconomic Volatility framework (Alesina & Tabellini, 2005), such residual variance patterns are often driven by temporary policy uncertainty or political upheavals. This means that spikes in Indonesia’s prosperity variance were likely linked to periods of fiscal uncertainty or global commodity price fluctuations but were not systematic enough to undermine long-term model stability.

These results confirm that the model satisfies the Gauss–Markov efficiency principle while mitigating variance bias through HAC adjustments. Theoretically, the model’s resilience to autocorrelation and the absence of dominant systematic variance supports the validity of the relationship between economic growth, government spending, institutional quality, and prosperity. This is consistent with the Institutional Quality–Growth Nexus (Acemoglu et al., 2005), which emphasizes that governance quality not only affects long-term growth but also shapes stability in the face of macroeconomic shocks.

### ***Conditional Error Correction Model (ECM)***

Table 7 presents the estimation results of the ECM, which aims to identify short-run dynamics and the speed of adjustment toward long-run equilibrium between prosperity (Prosperity Index) and its determinants, including GDP per capita growth, government expenditure, institutional quality, foreign direct investment, and urbanization. The ECM is an integrated form of the ARDL model that allows separation of short- and long-run effects while testing for cointegration. The ECT coefficient is the key indicator for understanding how quickly the system returns to its equilibrium path after a deviation.

Table 7 presents the estimation results of the ECM, which combines short-run dynamics with the adjustment process toward long-run equilibrium. The error correction term (ECT(-1)) coefficient of  $-1.8129$ , significant at the 1% level, indicates a very rapid adjustment mechanism toward long-run equilibrium when

deviations occur. Econometrically, a negative and significant ECT confirms cointegration among variables, meaning that short-run fluctuations in prosperity, economic growth, government expenditure, institutional quality, FDI, and urbanization will be corrected toward a stable long-run relationship. The positive and significant  $\Delta Y(-1)$  (0.3464) indicates persistence in prosperity, where an increase in the previous period boosts current-period prosperity.  $\Delta \ln \text{GDPpc}$  shows a significant negative relationship at the first lag ( $-1.2209^{***}$ ), reflecting potential short-term adjustment costs of economic growth, such as resource reallocation or structural changes that may not immediately translate into higher prosperity.  $\Delta \text{GE}(-1)$  is significantly positive ( $0.009^{**}$ ), indicating that increased government spending in the previous period contributes to current prosperity, consistent with Keynesian fiscal stimulus theory.

**Table 7**  
**Conditional Error Correction Regression (ECM)**

Variable	Coefficient	(SE, HAC1)	p-value
Constant	0	-0.13	1
Trend	0	-0.0043	1
ECT (-1)	-1.8129	-0.178	0.0000***
$\Delta Y(-1)$	0.3464	-0.1098	0.0070***
$\Delta \ln \text{GDPpc}$	-0.32	-0.1679	0.0775*
$\Delta \ln \text{GDPpc}(-1)$	-1.2209	-0.1526	0.0000***
$\Delta \text{SPz}$	0.0687	-0.0616	0.2832
$\Delta \text{SPz}(-1)$	-0.1064	-0.1129	0.3618
$\Delta \text{GE}$	-0.0099	-0.0072	0.1877
$\Delta \text{GE}(-1)$	0.009	-0.0038	0.0349**
$\Delta \text{FDI\_asinh}$	-0.1605	-0.0536	0.0097***
$\Delta \text{FDI\_asinh}(-1)$	0.2087	-0.042	0.0002***
$\Delta \text{IQz}$	0.2182	-0.0687	0.0068***
$\Delta \text{IQz}(-1)$	-0.0301	-0.0435	0.5004

ECM fit:  $N = 28$ ,  $R^2 = 0.9343$ ,  $\text{AIC} = -11.7304$ ,  $\text{SC} = 6.9204$

Notes: \*Standard errors are Newey–West (HAC, lag = 1). \*\*\*, \*, \* denote significance at the 1%, 5%, and 10% levels (p-values). ECT(-1) is the lagged error-correction term built from the UC+trend long-run relation; a negative and significant ECT confirms cointegration and measures the speed of adjustment toward long-run equilibrium.  $\Delta$  terms capture short-run effects. Deterministic trend is included in levels only (UECM specification).

Source: Authors' compilation.

FDI exhibits mixed effects:  $\Delta \text{FDI\_asinh}$  is significantly negative in the current period ( $-0.1605^{***}$ ) but significantly positive in the first lag ( $0.2087^{***}$ ), suggesting an initial adjustment phase where incoming FDI may not immediately boost prosperity but yields positive effects after economic and institutional adaptation.  $\Delta \text{IQz}$  is significantly positive ( $0.2182^{***}$ ), indicating that improvements in corruption control have an immediate positive impact on prosperity, consistent with the good governance hypothesis. Theoretically, an ECT with a large absolute value ( $>|1|$ ) indicates a high adjustment speed, consistent with Engle et al.'s (1987) argument that when the long-run relationship is strong, the system corrects disequilibrium rapidly. In this study,

the ECT value ( $-1.81$ ) implies that more than 100% of the deviation from long-run equilibrium is corrected within a single period, which, in Indonesia's context, can be associated with aggressive fiscal and monetary policy responses to economic shocks. The negative relationship of  $\Delta \ln \text{GDPpc}$  at the first lag aligns with the structural change hypothesis (Aghion & Howitt, 1992), where initial growth may cause temporary dislocations in certain sectors before benefits are widely realized. The positive significance of  $\Delta \text{GE}(-1)$  is consistent with the Keynesian multiplier effect, which posits that government spending stimulates aggregate demand and enhances social welfare, particularly in developing countries with moderate fiscal capacity. The mixed effects of FDI support Borensztein, De Gregorio, and Lee (1999) view that FDI benefits depend on the domestic economy's technological readiness and institutional quality. The significantly positive effect of  $\Delta \text{IQz}$  is in line with governance literature (Kaufmann et al., 1999), which emphasizes that corruption control improves economic efficiency, investor confidence, and equitable resource allocation.

### **Long-Run ARDL Multipliers**

Table 8 presents the long-run coefficient estimates from the ARDL model with an unrestricted constant and deterministic trend. These estimates capture how sustained changes in key determinants—GDP per capita, Equal Protection Index (SPz), Government Expenditure (GE), foreign direct investment (FDI\_ asinh), and control of corruption (IQz)—affect prosperity over the long run. The presence of a long-run relationship is confirmed through the bounds test, where a significant F-statistic indicates cointegration.

**Table 8**  
**Long-Run (UC + Trend) ARDL Long-Run Multipliers (HAC)**

Variable	Coefficient	(SE, HAC <sub>1</sub> )	p-value
Constant (long-run)	47.1641	-0.7631	0.0000***
Trend (long-run)	0.5399	-0.0091	0.0000***
$\ln \text{GDPpc}$ (long-run)	-0.2905	-0.1223	0.0415**
SPz (long-run)	0.6394	-0.0439	0.0000***
GE (long-run)	-0.0207	-0.0081	0.0310**
FDI_ asinh (long-run)	-0.2124	-0.0484	0.0017***
IQz (long-run)	0.0346	-0.0279	0.2462
Bounds test (UC+trend)	F-statistic = 3.8898	p-value = 0.0338	

Notes: \*Standard errors are Newey–West (HAC, lag = 1). Long-run coefficients are derived from the ARDL representation with Y lags 1–2 and exogenous lags 0–2 under an unrestricted constant and deterministic trend. \*\*\*, \*, \* denote significance at the 1%, 5%, and 10% levels (p-values). Variables:  $\ln \text{GDPpc}$  = log of GDP per capita; SPz and IQz are z-scores (per 1 SD); FDI\_ asinh is the inverse hyperbolic sine of FDI (%GDP); GE is general government expenditure (%GDP). “Trend (long-run)” is the deterministic drift per period in the long-run relation.

Notes: Bounds test follows the UECM Wald F-test for the joint significance of level terms under an unrestricted constant with deterministic trend. Ho: no long-run relationship (all level coefficients jointly zero). Decision is based on the F-statistic; rejection supports cointegration. Results are computed on the same aligned sample as the long-run table.

The estimation results show that in the long run, GDP per capita ( $\ln\text{GDPpc}$ ) has a significant negative effect on prosperity ( $-0.2905^{**}$ ), implying that economic growth does not automatically translate into greater prosperity if the distribution of its benefits is unequal. In contrast, SPz has a significant positive effect ( $0.6394^{***}$ ), indicating that protection of rights and legal equality are crucial in fostering sustainable prosperity. GE has a significant negative effect ( $-0.0207^{**}$ ), which may reflect a crowding-out effect or inefficient allocation of government spending in the long run. FDI\_asinh also has a significant negative effect ( $-0.2124^{***}$ ), suggesting that inward FDI flows have not consistently promoted long-run prosperity, possibly due to limited technological absorption capacity or weak domestic sector linkages. IQz shows a positive but insignificant effect ( $0.0346$ ), implying that while improving corruption control is important, its long-run impact on prosperity requires support from other factors. The Bounds test results (F-statistic = 3.8898; p-value = 0.0338) confirm the presence of cointegration, meaning these variables maintain a long-run equilibrium relationship with prosperity.

Theoretically, these findings reinforce the Inclusive Growth Framework (Ranis et al., 2000), which posits that economic growth contributes to long-run prosperity only if its benefits are equitably distributed. The positive effect of SPz aligns with the institutional theory of Acemoglu, Johnson, and Robinson (2005), which asserts that civil rights protection and legal equality foster broader economic participation, increase productivity, and minimize social conflict. The negative effect of government spending in the long run can be explained by the crowding-out theory (Barro, 1991), where excessive public expenditure may suppress private investment and economic efficiency. The negative impact of FDI supports literature highlighting the risks of an enclave economy (Alfaro et al., 2004; Hirschman, 1958) where foreign investment is concentrated in specific sectors without significant spillover effects to the domestic economy. The insignificance of IQz suggests that good governance alone is insufficient to foster long-run prosperity without inclusive institutions and adequate domestic economic capacity (North, 1990).

## **Discussion**

### ***GDP Per Capita and Prosperity***

The empirical pattern in which GDP per capita raises prosperity contemporaneously, turns negative at the subsequent lag, including a negative and significant adjustment in the ECM, and exhibits a negative and significant long-run association is consistent with a growing literature that decouples average income from multidimensional well-being. Classic accounts of structural transformation acknowledge that reallocating labor and capital toward modern sectors raises output yet entails transitional frictions, skill mismatches, sticky wages, and relocation costs that can temporarily suppress social welfare

(Kuznets, 2019; Lewis, 1954). In open economies, growth composition is pivotal: commodity-driven or enclave expansion weakens domestic linkages and constrains technological spillovers, limiting the diffusion of gains (Alfaro et al., 2004; Corden & Neary, 1982; Sachs & Warner, 1995). In such settings, multidimensional prosperity often diverges from per-capita income. The negative long-run coefficient resonates with evidence that growth without institutional upgrading and effective governance is fragile and unevenly shared (Acemoglu et al., 2005; Mauro, 1995; North, 1990; Sen, 1999). Since the 1990s, empirical studies have underscored that the distribution of growth benefits conditions whether growth translates into broader social prosperity (Deininger & Squire, 1998; Dollar & Kraay, 2002; Ravallion, 2004). More recent work shows that inequality undermines growth durability, weakens human-capital accumulation, and ultimately impedes progress in non-income dimensions of well-being (Berg & Ostry, 2017; Lakner & Milanovic, 2016; Ostry et al., 2014; Piketty, 2014). It is therefore unsurprising that beyond GDP frameworks argue for measurement systems that capture welfare comprehensively (Jones & Klenow, 2016; Stiglitz et al., 2009).

Three mechanisms are salient. First, short-run adjustment costs, like growth, trigger intersectoral reallocation and sector-specific investments whose benefits do not immediately materialize in household welfare and public-service quality; hence, the positive contemporaneous effect fades and may reverse at the next lag (Aghion & Howitt, 1992; McMillan et al., 2014). Second, asynchrony across prosperity pillars: institutional quality, social cohesion, safety, and environmental conditions require institutional reform and social protection to convert income gains into broad-based prosperity (Acemoglu et al., 2005; Sen, 1999). Third, growth composition: extractive or import-heavy patterns weaken domestic linkages and productivity spillovers, so income gains do not automatically improve other prosperity dimensions (Alfaro et al., 2004; Corden & Neary, 1982; Sachs & Warner, 1995). Policy implications follow. GDP per capita should be treated as a means, aligned with an inclusive growth agenda, robust social protection, high-quality public services, and institutional reform, so that average income gains diffuse and persist (Alfaro et al., 2004; Corden & Neary, 1982; Sachs & Warner, 1995). Managing the composition of growth, deepening value-added manufacturing, strengthening domestic supply-chain linkages, and improving financial intermediation amplify technological and productivity spillovers (McMillan & Verduzco-Gallo, 2014; Rodrik, 2016). Smart inequality-reducing policies, progressive taxation, human-capital investments, and labor-market institutions are not merely normative preferences; they are conditions for the durability of prosperity (Berg & Ostry, 2017; Ostry et al., 2014; Ravallion 2004).

Caveats are warranted. Potential endogeneity between per-capita income and prosperity is not fully eliminated within an ARDL framework; additional

robustness checks and credible instruments would strengthen causal claims (Pesaran et al., 2001). The design and weighting of the prosperity index can affect long-run sensitivity; benchmarking against HDI or MPI offers external validation (Alkire and Foster, 2011; Stiglitz et al., 2009). Finally, structural breaks associated with crises may alter dynamics; tests that allow for regime shifts would sharpen inference.

### ***Social Protection and Prosperity***

These findings indicate that prosperity is not reducible to income. Equal protection acts as an institutional bedrock that enables social protection to work by lowering transaction costs, curbing arbitrariness, and creating predictable public service delivery (North, 1990; Porta et al., 1998; Rodrik et al., 2004). Recent evidence reinforces this classic view. A meta-regression documents a positive and moderate long-run effect of the rule of law on economic performance, while a proxy for access to justice based on judicial capacity is positively associated with growth. This helps explain why institutional gains often materialize in long-run estimates, matching the strong positive long-run coefficient on SPz (Shamugia, 2025). Indonesia's current placement in the Rule of Law Index points to room for improving equal enforcement at the implementation margin, aligning with a short-run delay and long-run consolidation (World Justice Project, 2024).

On the social protection side, Indonesian studies document protective, promotive, and transformational effects. Recent evaluation of conditional cash transfers shows shifts out of agriculture and accumulation of productive assets among beneficiary households, indicating impacts beyond consumption smoothing (Yuliani & Nasrudin, 2024). Expanded national health insurance is associated with lower catastrophic health spending among the poorest, although regional service equity remains a priority. Work on persons with disabilities highlights coverage gaps that should be closed for fairness and effectiveness (Fattah et al., 2023; Probandari et al., 2025). At the macro level, social protection policies are linked to more inclusive growth, while governance quality improves well-being through perceived social fairness and trust in government. These psychosocial mediators require time to form, mirroring the short-run lag before institutional effects consolidate in the long run (Onyina & Baye, 2024). Regulatory experience in Indonesia underscores the centrality of implementation ecosystems. Major statutory changes reveal tensions between investment deregulation and labor rights, and they bring judicial review dynamics to the forefront. Credibility is forged in day-to-day delivery through first-instance court performance, affordable access to justice, and central and local coherence rather than statutes alone (Mahy, 2022). Integrating equal protection as an institutional enabler with social protection as the service instrument builds a more resilient architecture of prosperity.

### ***Government Expenditure and Prosperity***

These findings suggest that government expenditure does not automatically translate into higher prosperity, especially when composition and efficiency are weak. Classic theory points to a non-monotonic role of the state, while composition matters at least as much as size. When spending tilts toward low-productivity items, long-run outcomes deteriorate even if total outlays rise (Barro, 1990; Devarajan et al., 1996). Recent evidence confirms heterogeneous effects by function and time horizon. A new panel ARDL for the European Union shows that the short-run and long-run impacts differ across categories of public outlays, underscoring the need to reorient spending toward high-return uses (Sosvilla et al., 2025).

For Indonesia, the public expenditure agenda centers on spending better. The Public Expenditure Review highlights binding constraints to spending quality and calls for a shift toward human capital and productive infrastructure. At the same time, fiscal policy has recently been broadly neutral, with reallocation across items to fund new priorities while keeping the deficit within tight limits, and the budget framework emphasizes capital spending. This combination makes the composition of spending the primary lever for improving prosperity rather than simply scaling up totals (IMF, 2024; OECD, 2025; World Bank, 2020). Mechanistically, three channels align with these findings. First, composition: education, health, and productive infrastructure often deliver stronger prosperity gains than routine outlays, although results vary across countries and periods (Afonso et al., 2024; Coman, 2023). Second, efficiency and public investment management: new evidence documents sizable efficiency gaps through the investment cycle, while better planning and execution can raise infrastructure output and magnify multipliers in emerging economies (Adarov et al., 2024; Kapsoli, J., Mogue, T., & Verdier, 2023). Third, crowding in versus crowding out: when deficits expand in shallow financial markets, government borrowing may displace private credit. In Indonesia, banks' ample liquidity has so far absorbed government bonds without clear crowding out, but risks could rise as market conditions normalize (IMF, 2023).

Implementation matters as much as budgeting. Capital budget execution has been below full allocation in recent years, which weakens the translation of appropriations into development outcomes. Strengthening project selection, timely procurement, and local implementation capacity is essential to raise the prosperity impact of public investment (IEG – Independent Evaluation Group, 2025). Overall, the negative long-run coefficient on government expenditure is best read as a signal of composition and efficiency problems, not as a blanket indictment of fiscal policy. Policy should therefore tilt the portfolio toward high return uses, raise investment management efficiency, protect fiscal anchors, and improve capital budget execution so that public outlays crowd in private

investment and lift labor productivity in a way that is consistent with durable prosperity.

### ***FDI and Prosperity***

These findings indicate that the contribution of FDI to prosperity is conditional on composition, domestic linkages, and absorptive capacity. In theory, gains arrive through knowledge transfer, competitive discipline, and supply chain connections, with the strongest effects typically arising from vertical linkages between foreign investors and local suppliers (Javorcik, 2004). Recent evidence shows that positive impacts on domestic innovation depend on the ability to absorb knowledge and the quality of governance, which explains why benefits fail to materialize uniformly across settings (Bashir et al., 2024). Among middle-income countries, FDI fosters growth when it raises total factor productivity, again highlighting absorption as the key precondition for long-run gains (Mai Xuan & Le Tan, 2024). The short-run pattern in the estimates, with an initial drag followed by a positive lagged effect, is consistent with adjustment costs. Entry by global firms can compress local margins, alter input sourcing, and reallocate labor before some learning and demand spillovers reach capable domestic suppliers. Mode of entry matters. Comparative studies report that greenfield investment tends to deliver stronger development effects than mergers and acquisitions because it creates new capacity, jobs, and supplier opportunities rather than primarily reshuffling existing assets (Ahmed et al., 2023; Beuck et al., 2022).

Indonesia exhibits pronounced heterogeneity. At the province level, FDI is associated with faster growth, pointing to productivity and demand channels across regions (Fazaalloh, 2024). At the firm and labor market level, however, wage spillovers are not uniformly positive and can be negative in recipient provinces, suggesting that labor competition and supply chain structure shape who captures early surplus from FDI (Yasin & Esquivias 2023). In specific sectors such as mineral downstreaming, recent work warns of enclave dynamics when activity concentrates in one commodity and foreign ownership of technology limits deep linkages and transfer (Warburton, 2024). On the positive side, recent mapping shows a high share of domestic input purchases by foreign firms, which can translate into productivity gains for local suppliers provided standards, finance, and technical support are in place (World Bank, 2022).

Policy should therefore pivot from attracting flows to locking in benefits. The priorities are curated supplier development, supply chain finance and certification support, and sustained investment in skills and research and development to raise absorption. Rebalancing incentives toward greenfield in higher-value manufacturing and modern services, while strengthening regulatory predictability and competition policy, increases the odds that FDI will integrate

into the productive ecosystem rather than remain an isolated pocket of activity (Bashir et al., 2024; Mai & Le, 2024; Ahmed et al., 2023).

### ***Institutional Quality and Prosperity***

These findings indicate that improvements in control of corruption deliver immediate gains to prosperity, yet persistence requires institutionalization. Lower corruption reduces leakage, improves budget allocation, and builds trust, raising returns to public spending and private investment. Governance quality affects well-being through 2 mediators, perceived social fairness and trust in government, which develop gradually, consistent with the observed short-run lag before long-run consolidation (Ma et al., 2024). On market channels, credible enforcement improves credit intermediation. Dismantling crime-connected firms in Italy is followed by higher bank lending to legitimate businesses in directly affected municipalities by 0.8–2.1%, illustrating immediate business-environment gains (Buchetti et al., 2025). This aligns with the positive  $\Delta IQz$  signal in the short run, while durable long-run effects require deeper institutional reforms.

Cross-country evidence still finds an adverse corruption–growth link, with magnitudes varying by government size and institutional design (Afonso et al., 2024). Political stability, government effectiveness, rule of law, and control of corruption jointly promote inclusive human development, a core pillar of prosperity (Alkhawaldeh, 2025). Indonesia ranks 68 of 142 in the 2024 Rule of Law Index, with selected civil and criminal justice dimensions needing reinforcement (World Justice Project, 2024). Parallel assessments note stagnation or deterioration in the anti-corruption environment following legal changes that reduced the independence and effectiveness of the anti-corruption commission (Transparency International Indonesia, 2023). Field evidence shows that rigorous audits reduce leakage in local infrastructure projects, consistent with the short-run  $\Delta IQz$  effect (Olken, 2007). Moving from short-lived enforcement boosts to sustained prosperity requires strengthening the chain from prevention, detection, and prosecution to asset recovery and judicial integrity. Policy priorities: (1) pair measured enforcement with system reforms in procurement, taxation, and frontline services; (2) strengthen judicial integrity and appointments to prevent impunity; and (3) expand transparency through beneficial-ownership registries, e-procurement, and auditable performance reporting so gains persist into the long run.

### ***Urbanization and Prosperity***

These findings show that rapid urbanization can depress prosperity in the short run when infrastructure and housing lag behind the pace of population and job concentration. The literature documents that developing country cities often face congestion, fast-rising land and rent prices relative to incomes, and constrained

basic services, so agglomeration gains are not fully captured at early stages of urban transition (Henderson & Turner, 2020). When housing is unaffordable and daily mobility is costly, the home-to-job distance expands and productivity declines, which undermines non-income pillars of prosperity such as health, environment, and social cohesion (UN-Habitat, 2022; World Bank, 2025). Evidence from Indonesia indicates strong but uneven agglomeration benefits. Microdata studies find wage premia associated with agglomeration and regional endowments, signaling productivity channels where economic activity concentrates, though not uniformly across districts (Ridhwan, 2021). Yet, sprawling urban form without planning can erode social capital and widen service gaps, leaving many urban residents without access to the benefits of density (Civelli et al., 2023). The negative short-run coefficient on  $dUrban$  is therefore consistent with adjustment costs during fast urban expansion, especially when land use, mass transit, and housing supply lag behind (UN-Habitat 2022; Yudhistira et al., 2024).

The key mechanism is housing and connectivity. The latest macro report emphasizes that affordable, adequate, and well-located homes are the bridge from homes to jobs and are essential for converting urbanization into prosperity rather than marginalization (World Bank, 2025). In Jakarta, expansion of built-up areas has not always been matched by environmental and infrastructure capacity, increasing exposure to heat, pollution, and congestion that disproportionately burden vulnerable groups (Sarker et al., 2024). These patterns call for scaling up affordable housing, strengthening mass transit, and integrating land use so that agglomeration gains are locked in while city costs are contained (Henderson & Turner, 2020; UN-Habitat, 2022). Policy priorities follow directly. Normalize travel costs with reliable mass transit and transit-oriented development to shorten home to job distances. Expand affordable housing supply through streamlined permitting, more efficient land use, and safe long-term housing finance. Guide growth toward a connected system of cities rather than a few overloaded hubs to prevent land price and congestion pressures from concentrating. This agenda aligns with the view that urbanization becomes a prosperity engine when urban governance, housing, and infrastructure keep pace with population concentration (World Bank 2025; Yudhistira et al., 2024).

## **Conclusion**

This study finds that prosperity in Indonesia is not solely determined by economic growth but is strongly influenced by legal-based social protection and institutional quality. The ARDL analysis shows that equal legal protection has a significant positive long-run effect, while GDP per capita growth and foreign direct investment do not consistently enhance prosperity and may have negative impacts when benefits are unevenly distributed. Government expenditure exhibits a negative long-run effect, indicating inefficiencies and spending

composition issues. These findings highlight the necessity for development policies that balance economic growth with equitable distribution, institutional reform, and strengthened social protection to achieve sustainable prosperity.

These findings carry important policy implications. Strengthening legal equality and institutional effectiveness should be prioritized to ensure that economic benefits are distributed more inclusively. In addition, improving the efficiency and targeting of government expenditure, alongside expanding effective social protection programs, is essential for reducing vulnerability and fostering sustainable prosperity. However, this study is not without limitations. The analysis relies on aggregate national data, which may mask regional disparities and micro-level dynamics. Furthermore, the measurement of institutional quality through a single proxy may not fully capture the complexity of governance structures. Future research is therefore encouraged to incorporate disaggregated data, explore alternative institutional indicators, and extend the analysis using complementary methodological approaches to provide a more comprehensive understanding of prosperity dynamics.

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