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Articles

Kuznet's Hypothesis and Ibn Khaldun's Socio-Economic Dimensions

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Abstract

This study aims to prove the relationship between the hypothesis of Kuznets and Ibn Khaldun's socio economic dimension and income inequality. The object employed in this study is five municipal districts in Yogyakarta with the highest value of inequality throughout Java. This research utilizes the data panel which is a combination of annual time series of data from 2004-2017 and cross section of data from the five municipal districts in Yogyakarta. In this study, dynamic data panel regression is performed with the Generalized Method Moment (GMM) Arellano Bond. The relationship of the economic dimension of Ibn Khaldun and income inequality has been used to calculate income inequality Theil Entropy index which is being the dependent variable, and other variables as proxy for each dimension in Ibn Khaldun's socio-economic dimension models. The result of this study indicates that the linkage between Kuznets's hypothesis and Ibn Khaldun's socio-economic dimensions is similar since the economic growth shows insignificant variable resulted in both models.

Keywords: *Kuznets hypothesis, Ibn Khaldun's socio-economic dimensions, Entropy Theil Index, Generalized Moment Method (GMM) Arellano Bond.*

Introduction

The linkage between economic growth and inequality has increasingly been becoming a topic of global spotlight in a few decades ago (Shahbaz, 2010). Income inequality is disproportionate income distribution of the total national income in various regions in the country (Todaro, 2011). In general, the unequal distribution of income in developing countries affected high population growth resulting in declining per capita income. Inequality of income or income distributive difference not only in developing countries, but it can occur in different areas or regions (Yuliani, 2015). In the perspective of Islamic economics, the emergence of the concept of distributive justice is motivated by the fact that the economic theories that already exist are not able to realize justice in a global economy. In addition, the existing economic theory has not able to solve the problems of poverty and income disparity. It directs spiritual and moral-based mechanisms in the maintenance of social justice in any economic activity. It was motivated by the imbalance of wealth distribution that underlies almost all individual and social conflicts (Huda, 2015).

Ibn Khaldun, written in the third chapter of *Muqadimah*, discusses that the power of sovereignty is only fulfilled through the law, submission and obedience, acting under his rules and restrictions. Sharia shall not be established except by the king, there will be no glory for a king without a people. People will stand through the treasure, while the property will not be obtained except through exploitation. New concession will be obtained through justice. Ibn Khaldun's analysis strength lies in multidisciplinary and dynamic character. Justice and equitable distribution of income, which is part of the economic sector of society, is the main objective in any development in a region (Chapra, 2008).

Yogyakarta, one of the provincial-level regions in Indonesia, has a privilege in conducting the affairs of governance. Based on Law No. 13 Year 2012 on the privilege of Special Region, Yogyakarta has special powers including procedures for filling the position and the authority of governor and deputy governor. Yogyakarta consists of four counties and one city among others Sleman, Bantul, Kulon Progo Regency, Gunung Kidul regency and Yogyakarta itself (DI Yogyakarta in Figures, 2017). Because of its merits, this province has several problems for review. According to the Human Development Index of the 2013-2017, Yogyakarta occupies the second position of the 34 provinces in Indonesia. Meanwhile, the greatest value of the Gini Index Ratio throughout the island of Java by 0441% as of March 2018 (DI Yogyakarta in Figures, 2018). One of the problems is that there is the relationship between economic growth and income distribution in the districts/ city in special region of Yogyakarta.

Differences in economic growth amongst regions in Yogyakarta have been a striking force which allows the uneven distribution of income. Income distribution can not be assessed quantified using the Gini index. Gini index or Gini ratio values indicates the level of an unequal income distribution. However, the value of smaller Gini ratio indicates the level of income distribution is getting better (Rustiadi, 2009). Based on the Gini index obtained from BPS (Central Bureau of Statistics), Yogyakarta Gini index has increased in 2015-2017, as shown follows:
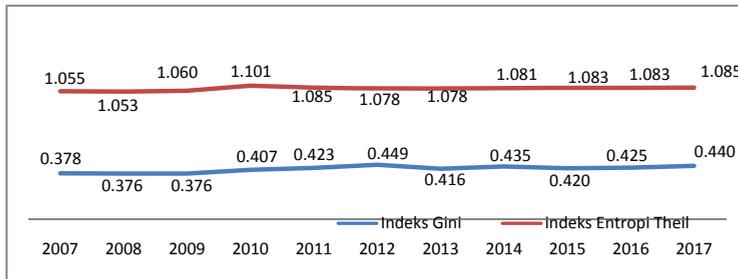
Figure 1. Graphs the Gini index and Theil's Entropy Index DI Yogyakarta 2007-2017
Source: Statistics 2017 (data processing)

Size ratio Gini index values ranging from 0 to 1; the closer to 0, the inequality in the region will be smaller, and vice versa getting closer to 1 the inequality in the region is getting worse. Based on the figure 1 above, the Gini Index and Theil Entropy Index had steadily increased in 2015-2017. The highest ratio of Gini Index in 2012 reached at 0449% and the highest of Theil Entropy index value in 2010 amounted to 1,101%. Gini index increased from 2010 to 2012 followed by the occurrence of Yogyakarta economic growth by the second quarter 2011, which occupied the negative numbers. Yogyakarta provincial economic growth in the second quarter of 2011 decreased by 3.89% against the first quarter of 2011. This growth occurred due negative agricultural sector production declined, while other sectors have increased (Press Release BD, 2011). In the same year, poverty line in the province of Yogyakarta as of March 2011 amounted to Rp249.629,- per capita per month. When compared to the situation in March 2010 amounted to Rp224.258,- per capita per month, then the poverty line during the last year increased by 11.31% (Press Release BD, 2011),

In the early stages of growth, differences in rates of economic growth will result inequality of income distribution in the region.

However, in the long term when the factors of production in the area is getting optimized, the difference in growth rates between regions tends to decrease output. It was marked by the increasing average per capita income in each region over time. The condition is consistent with the hypothesis known as the Kuznets hypothesis "inverted U" (Inverted U Hypothesis) (Kurniasih, 2013). According to Kuznets (1963), a regional imbalance in infancy, the first rise and then fall simultaneously with the rise in per capita income. This pattern is due to the fact that growth in the early stages of development tend to be concentrated in the modern sector of the economy which at the time was small in employment. Inequality widened in the gap between traditional and modern sectors. It increased because of the inequality in the modern sector improved more rapidly than in the traditional sector. Disparities between regions and levels of economic growth have a relationship that forms the curve "inverted U" over time (Gemmell, 1992).

The main principle of sustainable development is justice, equality, cultural, political and social interests, or the achievement of *maqashid sharia*. Imam ash-Syathibi argues that the main purpose of *maqashid sharia* is to keep three categories of law, among others: *daruriyyat*, *hajiyyat*, and luxuries. *Daruriyyat* in this case is to maintain the basic needs of every human being that is keeping the faith, nourishing the soul, nourishing minds and maintaining the honour and offspring, and maintaining the property. While *hajiyyat* means meeting the needs of the secondary, if not complied with this requirement will not threaten the safety but cause trouble. Furthermore, *tahsiniiyyat* keep things falsifies when it is not fulfilled would not threaten the safety nor cause trouble (Muzlifah, 2013).

In the translation of Ibn Khaldun's *Muqadimah,* third part of article 43 mentioned somethings that need to be considered by the religious laws to keep religion, soul, mind, descendant and treasure. This is being practiced

to minimize the injustice that led to the destruction of civilization and the collapse of the construction. In his writings, Ibn Khaldun considers the state serves as a tool to accelerate human development and well-being (Khaldun, 2008), Ibn Khaldun's thought about the balance produce socio-economic dimensions that include sharia (S), human (N), the authority of the sovereign (G), wealth (W), and the construction of (g) and justice (j) (Chapra, 2008).

In a study conducted by Omy Firliany Hanafi (2009) about the influence of the variables in the model of the dynamics of Ibn Khaldun to the poverty level, they noted that there were significant variables include total investment (W), Gini ratios (j), government expenditures on health and education (G) and the Human Development Index (N); while significant variable was the state constitution (S). Another highlighted point was a proxy variable of dimension in the socio-economic model of Ibn Khaldun. From these studies showed an association on the variables that are proxies of the socio-economic dimension of Ibn Khaldun. This study will analyse the Kuznets hypothesis and the relationship between Ibn Khaldun's socio-economic dimension of the inequality and the object of research district/city in special region of Yogyakarta. It is being implemented by using dynamic panel regression with the selection of the best models associated with inequality of income as the dependent variable, economic growth as an independent variable for the Kuznets hypothesis. As for the variables as proxy dimensions of socioeconomic include income inequality (j) as the dependent variable, the crime rate (S), local taxes (G), the total population (N), economic growth (W), and the Human Development Index (HDI) (g) as independent variables.

Research Methods

This study is a quantitative research where data gathered in the form of numbers and statistically analysed. The data in the form of panel data in time series and cross section of the districts/ city in special region of Yogyakarta from the year 2008 to 2017, including data Gross Regional Domestic Product (GRDP), top business field constant prices (ADHK), population, economic growth, local taxes, the Human Development Index (HDI), and the growth in the number of crime cases that will be used as a variable degree of criminality. The annual data are all the data of Yogyakarta Province. Furthermore, the data will be processed using dynamic panel regression method. The method of analysis to be used in this study are as follows:

Inequality Analysis

To analyse the level of income inequality among regions, we utilize Theil Entropy Index calculation. Theil entropy index does not have the lower limit or upper limit, just the greater the value, the greater the inequality and the smaller the index value more evenly (Kuncoro, 2014), as for the calculation is as follows:

$$T = \sum_{i=1}^{n} \left(\frac{Y_i}{Y}\right) \log\left(\frac{\frac{Y_i}{Y}}{\frac{P_i}{P}}\right)$$ .... (1)

Information:

T = Entropy Theil Index
Y_i = The GDP per capita district i
Y = Average GRDP per capita provincial
P_i = The total population of the district i
P = Total population of the province

Kuznets Hypothesis

According to Simon Kuznets (1955), in the early phases of industrialization in underdeveloped countries inequality will tend to expand before the strong income distribution and then will reduce inequality. This is what is known as the Kuznets hypothesis that forms the curve "inverted U". Kuznets hypothesis is a hypothesis to review the relationship between income per capita and equitable distribution of income. Kuznets hypothesis described as "inverted-U" was initially formed a curved line that describes the rising inequality rises with increasing per capita income. Simon Kuznets argues that in the early stages of economic growth, income distribution is likely to worsen, at the stage next one will improve income distribution. This observation known as the Kuznets curve or curve "inverted U". This curve illustrates the relationship between income per capita with the evenness of the distribution of income in a country, it can be seen in the graph below.
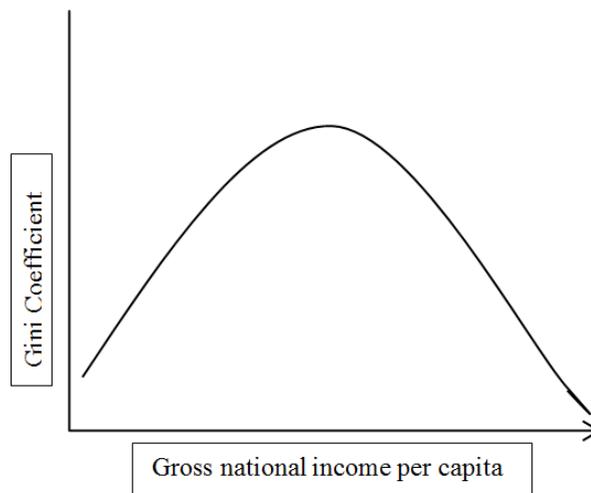
Figure 2. Curve "inverted-U" Kuznets
Source: (Todaro, 2011)

Socio-Economic Dimensions of Ibn Khaldun

Ibn Khaldun (2008), in *Muqaddimah* third part of article 43, wrote that the power of the sovereignty of a nation can only be fulfilled through the law, submissive and obedient to Him, acting under his orders and prohibitions. Human resources will be maintained through the help of property and possessions will be obtained through exploitation. Concessions will be able to run smoothly through justice. Ibn Khaldun's analysis is strength in multidisciplinary and dynamic character, since it connects all the important variables in the socio-economic and political. The other variables are law or rule beliefs and behaviours (S), human (N), government authorities (G), wealth (W), as well as development and justice (g) and (j). Each of these variables affect each other in turn. Dynamic reality will help explain how the moral political, institutional, social, economic, demographic and economic factors interact each other from time to time lead to the ups and downs of the economic situation of a region. In the long-term analysis, this dimension there is no ceteris paribus clause, because there are no variables are constant (Chapra, 2008).
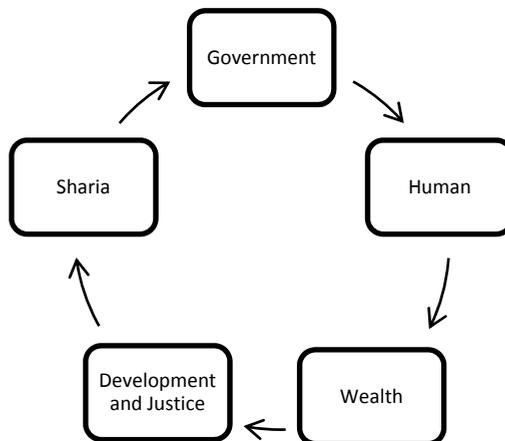
Figure 3. Dimensions of Socio-Economics Ibn Khaldun

Source: Sabit (2010)

Socio-economic dimensions of the model of Ibn Khaldun can be seen that development requires not only economic growth, but it also takes the role of government that accompanied the development of justice, good human resources, and the value of sharia. The implementation and proper management will accomplish the goals of development in an area. Because the purpose of development is not just about the high rate of growth in aggregate output, but reducing macroeconomic imbalances and economic disparities in an area (Chappra, 2000).

Regression Dynamic Panel

This study uses a dynamic panel regression method (dynamic panel model). A dynamic panel regression analysis on panel data by adding lagged dependent variable is used as an independent variable (Terza & Setiawan, 2016), The modelling of dynamic panel regressions are as follows:

$$Y_{i,t} = \delta Y_{i,t-1} + X'_{i,t}\beta + u_{it}$$ .... (2)

Where:

$Y_{i,t}$: The dependent variable, unit *cross section* to i for a period t

δ : Intercept a group effect / individual unit *cross section* to i for a period t

β : Vector sized constants K x 1 K is the number of independent variables

$X'_{i,t}$: Vector independent variable which is the observation unit *cross section* to i for a period t with a size of 1 x K

u_{it} : Component *error*

In a dynamic panel regression model, the approach of the Generalized Method of Moment (GMM) will produce parameter estimates

are unbiased, consistent and efficient. Here is the result of Arellano-Bond GMM estimation one step estimator:

$$\binom{\hat{\delta}}{\hat{\beta}} = \left[\left(N^{-1}\sum_{i=1}^{N}(\Delta y_{i,t-1}, \Delta x_i)'Z_i\right)\widehat{W}\left(N^{-1}\sum_{i=1}^{N}Z_i'(\Delta y_{i,t-1}, \Delta x_i)\right)\right]^{-1}$$
$$\left[\left(N^{-1}\sum_{i=1}^{N}(\Delta y_{i,t-1}, \Delta x_i)'Z_i\right)\widehat{W}\left(N^{-1}\sum_{i=1}^{N}Z_i'\Delta y_i\right)\right] \quad \text{.......................... (3)}$$

Where:

Zi   : Matrix valid instruments

$\widehat{W}$: Unbiased and consistent estimates for *w (LXL)* L is the number of variable instruments.

In Nabila and Setiawan (2016), to get the two-step estimator estimates the weights with the way to substitute, with: $\widehat{W}\widehat{A^{-1}}$

$$\widehat{A^{-1}} = N^{-1}\sum_{i=1}^{N}Z_i^i\Delta v_i\Delta v_i^iZ_I \quad \text{.......................... .... (4)}$$

As for the estimation of the two-step GMM Arellano Bond is as follows:

$$\binom{\hat{\delta}}{\hat{\beta}} = \left[\left(N^{-1}\sum_{i=1}^{N}(\Delta y_{i,t-1}, \Delta x_i)'Z_i\right)\widehat{\Lambda}^{-1}\left(N^{-1}\sum_{i=1}^{N}Z_i'(\Delta y_{i,t-1}, \Delta x_i)\right)\right]^{-1}$$
$$\left[\left(N^{-1}\sum_{i=1}^{N}(\Delta y_{i,t-1}, \Delta x_i)'Z_i\right)\widehat{\Lambda}^{-1}\left(N^{-1}\sum_{i=1}^{N}Z_i'\Delta y_i\right)\right] \quad \text{.......................... (5)}$$

Significance Parameters Test

Parameter significance test is performed to determine whether or not a relationship in the regression model, using wald test. Wald test is the test used to determine the significance of the models simultaneously. When the value of the test statistic W (wald) greater than the table Chi-square or a p-value <a then would reject Ho and accept Ha is at least one significant coefficient in the model (Nabilah & Setiawan, 2016). Furthermore, the partial testing to determine the relationship of each independent variable

on the dependent veriabel. It can be completed using the Z-test test is performed to determine the significance of the partial models. If the p-value on the Z test is less than the critical value used is 5%, then it will reject Ho and accept Ha (Terza & Setiawan, 2016).

Text Specifications Model

According Terza and Setiawan (2016), a model specification test was conducted to determine the validity of the use of the instrument variables exceeds the number of parameters expected and to test the consistency of the estimate obtained from the Arellano-Bond GMM regression.

Sargan Test

Sargan test is done to look at the validity of the use of instrumental variables whose number exceeds the number of parameters or their alleged overidentifying conditions. The p-value <a value (a = 5%) would then reject Ho is the condition overidentifying valid restriction in the estimation model.

Arellano-Bond Test

Arellano-Bond test was used to test the consistency of the estimates gathered from the estimation of the two-step GMM estimator. This test was conducted to see whether or not the first difference residual autocorrelation in order to i. When the p-value at the test statistic m2 <a (a = 5%), wether Ho rejected or not, there is autocorrelation in error first difference-th order.

Discussing Income Inequality

Income inequality is a problem often encountered in each area. The level of inequality in a region different from other regions depending on the situation in the area. Kuznets (1955) analysed economic growth and revenue in the US which was to determine the distribution of income

in each area before and after the direct tax. It was also mentioned that the support from the government who granted the economically disadvantaged groups had failed in recent decades in the United States and Britain. However, studying from Germany, the distribution of income after direct taxes, including contributions from the government assistance, provided the difference in value unequal to the size distribution of income before taxes. In addition, the average income per capita in rural areas is usually lower than in the urban population, since the productivity per capita in urban areas tend to rise faster than in rural agriculture. It promotes unequal distribution of total revenue which will increase. Such factors as the industrialization and urbanization or the shift from agriculture to industry led into unequal income distribution. Unbalanced income structure is in tandem with the low level of per capita income (Kuznets, 1955).

According to Kuznets (1955), studying the economic growth of a country need to do with the social science disciplines in order to understand the patterns of population growth, natural, and technological change. He assumes that the revenue structure is rather uneven in developing countries than in more developed countries, especially in the West, North Europe, USA, Canada, Australia and New Zealand. It has some involvement, among others are savings, the low growth rate of real income per capital and political and social system failure in initiating the practice of government. According to him, in the early phases of industrialization in underdeveloped countries inequality will tend to expand before the strong income distribution and then will reduce inequality.

Studies on the equitable distribution of income turns out previously reviewed in the Ibn Khaldun's view on East. His work *Muqaddimah* critically has been examined and debated by social scientists, theologians, historians and even economists. *Muqaddimah* was first published in 1858 (Maarif, 1996). Broadly speaking, his work addresses six basic chapters,

among others: mankind civilization, desert civilization (the tribes and the nomads), the king's power and levels of government, city people civilization, livelihoods and its business (*kasab*), and the discussion of science and how to obtain it (Khaldun, 2008). Islamic economic system with its characteristics theoretically provide balance and stability. In doing so, a balance can be achieved here, while the state needs to do some important steps which are disclosed as Ibn Khaldun's argument. Ibn Khaldun put a variable which is connected with a prerequisite for the realization of a prosperous country (Huda, 2015).

The story began with the Persians, in the periode of a son of King Bahram, Mobedzan, when religious leaders among them protested for the king on injustice. Mobedzan said the strength of sovereignty only be met through religious laws, submission and obedience to God, acting under the orders and prohibitions. New sharia straight through sovereignty which would not be obtained through the exploitation. The justice is upheld among mankind (Khaldun, 2008). Ibn Khaldun formula found in chapter three of article 43 which was being implemented the sharia, the role of government, society, wealth, development and justice (Huda, 2015).

Both ideas have several similarities and differences. The first dissimilarity is the early emergence of their thoughts. Kuznets hypothesis came from studies conducted using economic data in order to know the cause of long-term changes in the distribution of income before and after taxes. Meanwhile, the emergence of Ibn Khaldun's thought was due to the negligence of a king who had unjust attitude towards people. Furthermore, Kuznets hypothesis had been produced as a result of a review of long and short term effects in the equality of income distribution with industrialization as a cause of income distribution changes. Meanwhile, Ibn Khaldun's observation based on the reality happened in the short term period. However, Ibn Khaldun have the five affected variables, compared

to Kuznets hypothesis which has only two principal variables of growth and inequality (Kuncoro, 2000).

Nonetheless, both these ideas have similarity in realizing the goal of equity. In the Kuznets hypothesis verification, it refers to the causes of inequality in income distribution (Kuznets, 1955). In Ibn Khaldun's, it denotes the primary purpose of Islamic economic principles that uphold justice and prosper (Fauzia & Riyadi, 2014). The similarities of both ideas can be seen from the estimation of income inequality in the districts/ city in special region of Yogyakarta in 2004-2017, as described follows:

Table 1. Results of the estimated Kuznets hypothesis and Ibn Khaldun's

Variables	Coefficient	standard Error	Z	P-Value
Equation I				
Entropy theilL1	, 8938423	, 0937678	9.53	0,000
PE	, 0074512	, 0126628	0.59	0,556
Cons	-, 0031287	, 0947047	-0.03	0,974
Prob. Wald test				0,000
Equation II				
Entropy theilL1	0.47952	0.0729182	6.58	0,000
Crime (crime rate)	0.00053	0.0001108	4.78	0,000
Lntax (Local Taxes)	0.03737	0.0180433	2.07	0.038
Lnpop (Population)	-1.4693	0.2870039	-5.12	0,000
PE (Growth)	0.01988	0.0215159	0.92	0.355
IPM	0.01574	0.0065467	2.4	0,016
Cons	17.9081	3.551725	5.04	0,000
Prob. Wald test				0,000

Source: data processing

Furthermore, similarities of the two ideas are the estimation of the Kuznets hypothesis testing and Ibn Khaldun's argument as presented in Table 1. The tests are carried out at the districts/ city in Yogyakarta in

2004-2017. The tests are the same results as that economic growth has no significant effect on inequality. The yield on the hypothesis Kuznets estimates show the p-value of more than 5% that is 0,556 and the socio-economic dimension of Ibn Khaldun testing reveals a p-value equal to or more than 5% that is 0.355. Meanwhile, other variables that affect the socio-economic dimensions of inequality in Ibn Khaldun's among others are the crime rate (S), local taxes (G), the total population (N), and the Human Development Index (HDI) (g). Each of the variables that are proxies of each dimension on the Khaldun's model has a significant positive effect of income inequality in the districts/ city of Yogyakarta. However, a variable number of the population has a significant negative effect of income inequality in this province.

Furthermore, on the hypothesis of Kuznets, economic growth has no effect on income inequality in Yogyakarta, since there are such other factors as poverty and patterns of life in society. Although inequality in Yogyakarta reaches high position, but it represents also high happiness index value. An index value of happiness in Yogyakarta is quite high. In 2017, Yogyakarta happiness index value discloses 72.93%, the highest figure of any other region on the island of Java. When happiness and inequality are high, it can be said that happiness in this province does not realised from the large amount of material. Happiness index has been derived from three components which is not measured in numbers, yet including life satisfaction, feeling and meaning of life. Of the three components, there is a difference in value between urban and rural areas of Yogyakarta. The index value of the three components of happiness in urban areas are higher than that in rural areas. As the graph below:
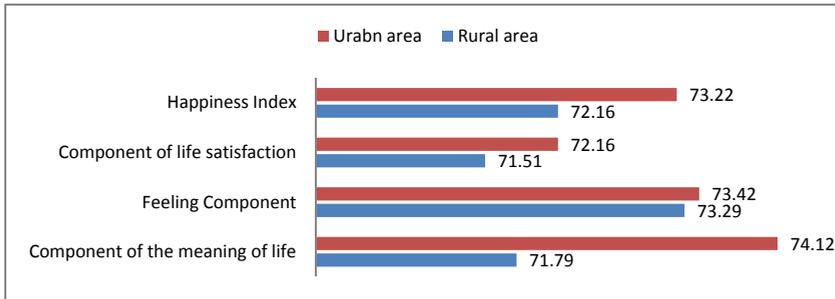
Figure 4. Happiness Index and Urban and Rural in Yogyakarta, 2017
Source: the Central Bureau of Statistics Yogyakarta (data processing)

From the figure 4, the happiness index value grasps to 73.22% in urban areas which is higher than in rural areas, by 72.16%. This fact is similar in the three constituent components. However, the satisfaction of life consists of two things: personal life satisfaction and social life satisfaction. For personal life satisfaction, the urban life satisfaction is higher than that of in rural areas. Instad, in term of social life satisfaction, that in rural areas has a higher value, by 76.88% compared to than that of the urban marking at 75.69%. It can be seen in the graph below:
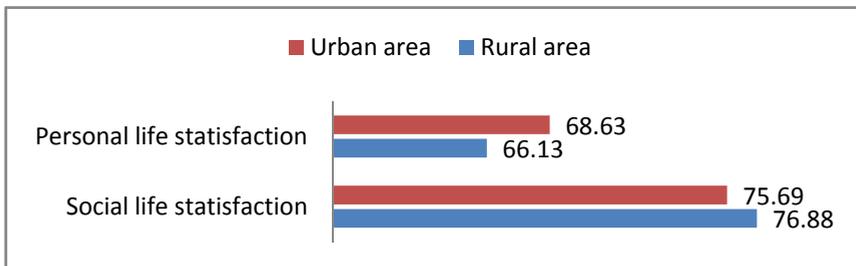

Figure 5. Urban and Rural Life Satisfaction in Yogyakarta, 2017
Source: Press Release, the Central Bureau of Statistics Yogyakarta (data processing)

From the figure 5, happiness in the province of Yogyakarta has not been derived from the materiality. Despite high inequality, the different components of happiness in the urban and rural communities influence

the happines index in Yogyakarta. For the life satisfaction components, feeling and meaning of urban areas is higher than that in rural. The distance between the two is not too far, it is due to the fact that rural life of Yogyakarta is simple. Based on these results, both the eastern and western thought seem to be different, yet having similarity in the equitable distribution of income.

Such development experts as Fei and Ranis (1964), Kunznets (1966) and Adelman and Morris (1973) argue that income inequality has been determined by the size of the country, the base of natural resources, and adopted policies. In other words, the activities of the structural dimension of factors need to be considered in addition to the rate of economic growth (Kuncoro, 2000). The primary purpose of Islamic economics is to realize prosperity. Islam has no longer focused on the growth of wealth as separate entity by means of distribution and realization of the demands of social justice. Islam regulates fairness and balance between the rights and obligations between the individual and society, between the physical and the spiritual, and the world to the hereafter (Huda, 2015).

Obtaining happiness in the world and the hereafter, every Muslim must be able to create benefits (*maslahah*) in all circumstances, both material and nonmaterial. *Maslahah* can be met through the five basic things, such as religion, life, intellect, family, and descent as well as treasure (Wibowo, 2006). The relationship between the hypothesis Kuznets with Ibn Khaldun's socio-economic dimension is illustrated into a chart, as following figure:
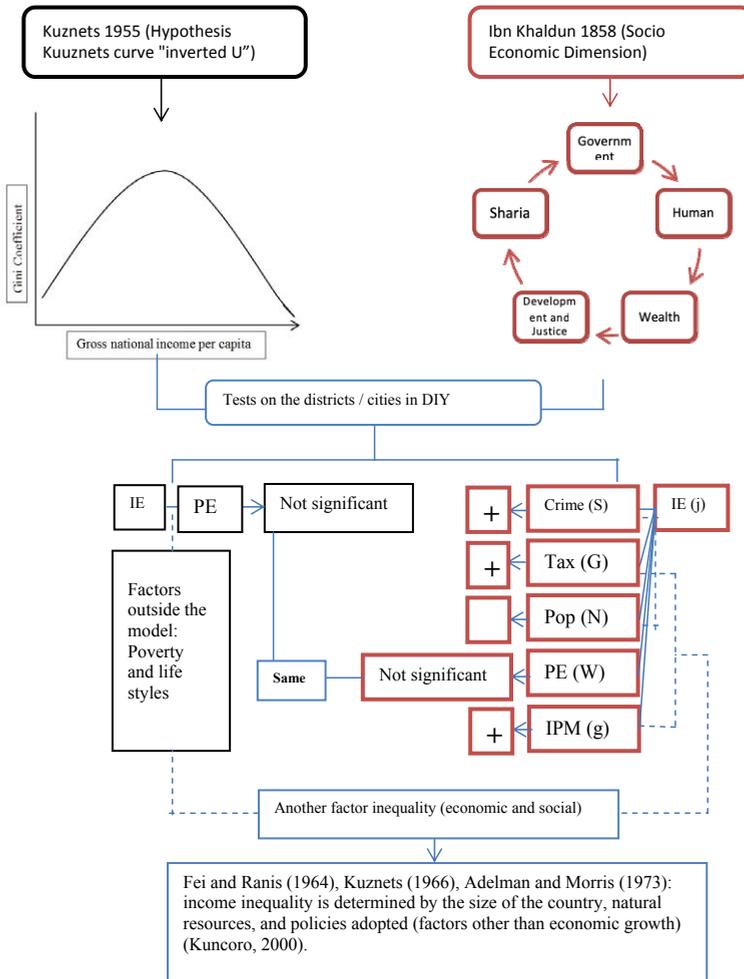
Figure 6. Kuznets's Hypothesis and Khaldun's Argument

Conclusion

Considering the Kuznets hypothesis and Ibn Khaldun argument, it is important to note that studying economic growth of a country requires to implant social science in order to understand the patterns of population growth, natural, and technological change. Analysing Kuznets

and Khaldun arguments on economics reality will be an exemplary study how such great thinkers are complimentary. This study also reveals that the past though are doable applied into present economics challenges. Furthermore, such synthesis may be implimented through exploring other great thinkers within Islamic and economics world.

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