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Epistemological Foundation of ESG-Based Investment in Indonesia's Economic Policy

[1*]Putri Dwi Wahyuni, [2]Mohammad Mukhtasar Syamsuddin
[1]Faculty of Economics and Business, Universitas Gadjah Mada, Yogyakarta, Indonesia
[2]Faculty of Philosophy, Universitas Gadjah Mada, Yogyakarta, Indonesia
putridwiwahyuni1990@mail.ugm.ac.id [1*]

Address: Bulaksumur, Depok District, Sleman Regency, Special Region of Yogyakarta 55281
Author correspondence: putridwiwahyuni1990@mail.ugm.ac.id

Abstract. *This research aims to explore and analyze the essence of ESG (Environmental, Social, and Governance) based investment in Indonesia's economic policy through an epistemological perspective. This research examines how the government acquires and processes knowledge about ESG, and how this knowledge affects policy effectiveness, especially in creating social justice. This research uses a quantitative approach with literature study as the data collection method. Secondary data was obtained from policy documents, government reports, and related academic publications. Data analysis was conducted descriptively with a philosophical interpretation of ESG implementation. In the context of developing practical solutions to realize social justice, this research uses two main approaches, namely Utilitarianism: Assessing the impact of ESG-based economic and investment policies on people's welfare by considering the benefits and costs for various groups and Pragmatism: Evaluating the effectiveness of ESG policies in achieving practical goals, such as environmental sustainability, social welfare, and inclusive economic growth. The results show that ESG policies in Indonesia are influenced by global standards that are not fully compatible with the local context. ESG implementation is often driven by international pressure, especially from foreign investors. This research highlights the importance of transparency and accountability in ESG reporting, as well as the need for policies that are more inclusive and considerate of small businesses.*
Keywords: *ESG-based investment, economic policy, epistemology, utilitarianism*

1. INTRODUCTION

In the midst of the current issue of environmental pollution, ESG (*Environmental, Social, and Governance*) based investment is being discussed. ESG-based investment not only considers financial elements in making investment decisions, but also considers ESG components as non-financial factors. Around the world, ESG (*Environmental, Social, and Governance*) based investments have increased rapidly. Many countries including Indonesia have implemented ESG factors in their investments. ESG investments could surpass US$53 trillion in asset value by 2025 due to increasing demand from global investors (www.bloomberg.com, 2021). In Asia, demand for *sustainable investing* is increasing in China (up 80% in 2021) and Japan (up 34% in 2018-2020) (Global Sustainable Investment Review 2020). Demand for *responsible investing* is also increasing among pre-retirees looking to align their personal values with retirement goals (public pension funds in the United States applied ESG factors to at least US$3 trillion in assets in 2018) (Center for Retirement Research at Boston College 2020 in https://www.manulifeim.co.id/). ESG investing is becoming an

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emerging investment strategy that offers investors multiple benefits in various forms (MSCI, 2020).

In Indonesia, this has been implemented since 2009, when these criteria were incorporated into the company's financial statements. However, to date, not all companies in Indonesia have implemented ESG-based investments. In this regard, the government issued relevant policies, such as the National Action Plan for Reducing Greenhouse Gas Emissions. ESG-related legislation is one of the many laws created by Indonesia to support sustainable business practices. For example, the Financial Services Authority has issued regulations requiring publicly listed companies to report on all types of environmentally and socially relevant activities in their annual reports. In addition, Indonesia's commitment to the Sustainable Development Goals also drives ESG implementation across all sectors of the economy. This is due to climate change and the Covid-19 pandemic - strengthening national and global awareness on the importance of ESG observance.

Based on the *Enhanced Nationally Determined Contribution* document issued in 2022 in Indonesia) regarding national policies related to climate change. Each country is required to increase its NDC target to align with the scenario of preventing global temperature rise of no more than 1.5 degrees Celsius. Gradually, Indonesia's GHG emission reduction target will be aligned with the long-term policy of the *Long-term Strategy for Low Carbon and Climate Resilience* (LTS-LCCR 2050) towards net-zero emission by 2060 or sooner (https://ppid.menlhk.go.id/). In short, ESG is important so that infrastructure investment based on “green” will increase. The ESG concept also leads to epistemological issues, with the way ESG *disclosure* information is created, validated and used in economic policy decision-making. However, this happens in the context of ESG *disclosure* application and assessment. Responsible (ethical) investment can be defined as an investment in which the decision to form an investment portfolio is based on the integration of several non-financial criteria including social, environmental and ethical (Cowton, 2018).

Indonesia's capital market has been positively impacted by the development of sustainable investment. Companies in Indonesia that are listed on the stock exchange and implement ESG continue to increase. In 2015 there was only one ESG-based mutual fund product with an AUM of IDR 36 billion, while as of December 30, 2020 the number had reached 14 products with an AUM of more than IDR 3 trillion. Increased ESG awareness among issuers and capital market investors prompted the Indonesia Stock Exchange (IDX) to launch a new index, IDX ESG Leaders, in mid-December 2020 (ojk.go.id)

Overall, referring to the issues related to the implementation of ESG-based investment in Indonesia, the complexity of sustainability, international pressure, limited leadership elements and difficulties in combating environmental and social issues at the ground level are part of the phenomenon. While steps to update ESG standards are being made, problems associated with *greenwashing*, knowledge gaps, and environmental and social sustainability crises all suggest that there is still a lot of work to be done to ensure that ESG-based policies are not just an afterthought, but also deliver the best sustainability impact in Indonesia. From the perspective of epistemology, a branch of philosophy that refers to the foundations of knowledge or beliefs that underlie a field of study. In the context of ESG-based investment, this epistemological foundation is crucial as it shapes the way we understand and interpret the relationship between the economy, environment and society. In the case of ESG, the government and monetary authorities in Indonesia speak of policies that are based on certain value preferences. Specifically, the Indonesian government views reducing carbon emissions as a value. Meanwhile, ESG analysis does require methods that take into account this normative dimension (Weber, 2008).

By looking at ESG policies from an epistemological point of view, this research is expected to provide new insights into the effectiveness of these policies and provide suggestions for future improvements. The *purpose of* this *research* is to explore and analyze the essence contained in the application of ESG-based investment principles in Indonesian government policies from an epistemological perspective. The *motivation of* this *research* is to make a real contribution to improving sustainability where Indonesia has abundant natural wealth but environmental challenges also accompany it. By analyzing ESG policies in depth, it is expected to encourage more effective and adequate policy implementation in preserving the environment. Through philosophical studies, it is expected to find strong rational and empirical justifications supporting the implementation of ESG in Indonesia as a whole. In terms of *empirical contribution*, this research will contribute to the public policy literature by providing insights from public sector investment practices. This research will provide a critical analysis of the implementation of ESG principles. For the private sector and investors, this research will provide critical insights on ESG investment policies in Indonesia that may impact their investment decisions. This research will also have a significant policy contribution in terms of providing recommendations on how the Indonesian government can strengthen its knowledge-based approach towards shaping ESG investment practices as well as how to measure and evaluate the effectiveness of these policies.

2. LITERATURE REVIEW

Legitimacy Theory

Dowling & Pfeffer (1975) created legitimacy theory, which considers the interaction between companies and society. This theory considers that society is an important component in the long-term development of the company (Dowling & Pfeffer, 1975). According to legitimacy theory, organizations will seek "to perceive and plan strategies" to ensure the legitimacy of their business activities, an internal and external effort to acquire and convince their target groups that their efforts are compatible with relevant social values. In terms of ESG-based investments, on the other hand, it is expected that companies and governments behave "in accordance with social norms and expectations related to good governance, environment, and social" (Deegan, 2002).

In relation to ESG policies, governments may provide such policies on the basis of maintaining or strengthening the legitimacy of the public, investors and the international community. So an important aspect of legitimacy theory is: Pragmatic Legitimacy in which the government's action in providing ESG may be triggered by the need to gain support from economic or political stakeholders, e.g. foreign investors, *Moral Legitimacy* in which the provision of ESG may also be analyzed as a response to moral and ethical demands on its duties and ethical and social obligations, *Cognitive Legitimacy* in which ESG is accepted as a norm or as a standard, "as right" by the rest of society and the international community. The theory is epistemologically relevant as it centers on understanding how investment practices and knowledge can create or reinforce legitimacy. ESG policies can be seen as a response to social demands to ensure sustainability and as a representation of corporate and government commitment to global challenges such as social inequality and climate change.

Environment Social Governance (ESG)

According to Li et al., (2021) the *Environmental, Social, and Governance* (ESG) principle is a framework system that includes environmental, social and *governance* factors. ESG is used by investors in making investment decisions on the grounds that companies that disclose ESG have a competitive advantage that can reduce investment risk. Companies that disclose ESG are believed to have a great responsibility for the environment, social and corporate governance so that conflicts between stakeholders can be mitigated (Ermawati et al., 2023).

ESG emerged to fulfill the interests of investors, governments, suppliers, consumers. Companies that disclose ESG will have a positive impact on society. The community will support the company's existence because they feel that the company's operational activities can improve the welfare of the community and the community feels undisturbed (Cakranegara, 2021). ESG serves as a framework that helps investors evaluate the impact of investments on environmental, social, and efficiency aspects of corporate governance (Hawley & Williams, 2002).

Table 1. ESG framework (international frameworks)

Dimension	Factors	Definition
Environmental (E)	• GHG emissions • Energy consumption and efficiency • Air pollutants • Water usage and recycling • Waste production and management (water, solid, hazardous) • Impact and dependence on biodiversity • Impact and dependence on ecosystems • Innovation in environmentally friendly products and services	Environmental matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.
Social (S)	• Workforce freedom of association • Child labor • Forced and compulsory labor • Workplace health and safety • Customer health and safety • Discrimination, diversity, and equal • Opportunity • Poverty and community impact • Supply chain management • Training and education • Customer privacy • Community impacts	Social matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.
Governance (G)	• Codes of conduct and business principles • Accountability • Transparency and disclosure • Executive pay • Board diversity and structure • Bribery and corruption • Stakeholder engagement • Shareholder rights	Governance matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.

Sumber: (V. R. Sari et al., 2023); (Li et al., 2021)

The Relationship Between Science (Epistemology) and Values in the Context of ESG

The relationship between science and values in the context of ESG (*Environmental, Social, and Governance*) refers to the complex interaction between scientific facts (science) and the ethical, moral, and social values that underlie decision-making regarding sustainable investment and business. Science provides an objective basis for assessing a company's environmental, social and governance impacts, while*values* define the ethical and moral objectives of decision-making (Mubarok, 2022).

Science as a Basis for Evaluation: In ESG, using science to measure and analyze data related to a company's impact on society and the environment. For example, a company may use scientific data on water use, carbon emissions or biodiversity to understand the environmental impact of its operations.

Values as an Ethical Guide: While research provides data, values play an important role in determining right or wrong ESG policies. Values such as social justice, sustainability, and transparency drive companies to implement practices that are not just financially beneficial.

Synergy Between Science and Values: A company's ESG strategy becomes more effective and meaningful when science and values are combined. For example, science can discover the risks of climate change, but how seriously a company takes this information and takes action based on its business environmental values. When businesses combine science with ethical principles, they are often better able to meet stakeholder expectations and gain public trust.

Utilitarianism Rationale in ESG

The view of utilitarianism is basically an ethical-ethical understanding that places actions that can be said to be good are those that are useful, provide benefits and are profitable, while bad actions are those that cause suffering and harm. Furthermore, happiness, according to utilitarianism's point of view, is *impartial* because everyone must want happiness and not suffering, therefore the concept of utilitarianism bases happiness as a touchstone of morality which is "*impartial promotion of well-being*", namely upholding happiness / well-being that is *impartial*. From here, we get the reason why Jeremy Bentham termed happiness as "*The greatest number*", namely because an ethical or moral action can be felt by everyone through happiness, because the nature of happiness should be impartial and can be felt by anyone (Pratiwi et al., 2022).

In ESG, utilitarism plays a role in:

a) Environmental Impact Management: Ensuring that many people experience environmental benefits such as clean air or reduced carbon emissions.
b) Social Wellbeing: Making a positive impact on society as a whole through access to education, healthcare, and employment opportunities.
c) Economic Sustainability: Providing balanced monetary returns to communities, companies, and investments

3. METHODS

This type of research is quantitative with a descriptive approach through a Philosophical/Conceptual study: This research analyzes philosophically the idea of ESG in economic policy. This research focuses on how ESG epistemology or knowledge about ESG affects the policy decision-making process. The data source used is a literature study of secondary data such as data obtained from policy documents, government reports, academic publications related to ESG and economic policy which are then explored based on existing concepts, theories and thoughts.

In the context of developing practical solutions to realize social justice through ESG based investments, utilitarianism and pragmatism methods are used to provide a results-oriented approach to ensure that policy benefits exceed costs and create a balance between environmental sustainability, social welfare, and economic profit.

4. DISCUSSION

Epistemology and ESG Standards

Various world economic problems have emerged and have been growing since human civilization existed which require immediate solutions to overcome them. For example, the global economic and financial crisis in several developed countries, the increasing world population growth, the increasing food crisis due to resource depletion, and so on are world economic problems that need immediate handling (Putri, 2020). Current issues arise related to ESG-based investments. In the midst of the current issue of environmental pollution, ESG (*Environmental, Social, and Governance*) based investments are being discussed. They not only pay attention to financial factors in making investment decisions, but also consider ESG components as non-financial factors.

From an epistemological perspective, ESG policies in Indonesia can be understood as part of the globalization of sustainability knowledge. ESG standards are often developed by international institutions, such as the UN *Principles for Responsible Investment* (PRI) or the *Global Reporting Initiative* (GRI) that may not always fit the local Indonesian context. This discussion will critique how ESG knowledge and standards are translated into local policies, and whether there is a gap between global standards and implementation on the ground.

ESG also known as *Environmental, Social and Governance* is a set of standards that refers to three main standards for measuring aspects of sustainability. In the business world, the term is often used as a metric used when making a decision to invest in a particular entity. It is also used to refer to a category of reporting relating to the impact of a company's business activities. To consider the risk factors, sustainability, and growth potential of the company to be invested in, this ESG component becomes important to consider. In the perspective of philosophy, especially the philosophy of science, the essence of the purpose of philosophy is to give birth to Science or in Kattsoff's view, the purpose of philosophy is to collect as much knowledge as possible, and publish and organize it in a systemic form, for the benefit of human life. By philosophizing, humans will have guidelines for thinking, behaving and acting in the face of symptoms and events that arise in the surrounding nature (Misbahuddin, 2012).

Indonesian Government Policies related to ESG

This discussion will focus on analyzing government policies related to environmental sustainability, social responsibility, and corporate governance. Policies or regulations that explicitly mention ESG, such as policies on clean energy, natural resource conservation, or social policies. Here are some regulatory policies regarding ESG.

a. ESG: Law No.16/2016 Ratification of the Paris *Agreement*

   Law No. 16/2016 on the Ratification of the *Paris Agreement to the United Nations Framework Convention on Climate Change* (peraturan.bpk.go.id). This regulation was formed as a response and form of Indonesia's seriousness in efforts to control the continuation of climate change. Together with other members of the international community, the Government of Indonesia is committed to actively contributing to climate-related actions, including mitigation and adaptation aspects. *Environmental, Social, and Government* (ESG) as a framework for implementing sustainability principles in business and investment practices, in line with the climate change goals promoted by the *Paris Agreement*. Companies are expected to implement a sustainable approach or ESG in business activities with one of the goals being to address climate change by limiting global warming.

b. Perpres 59/2017 Achieving the Sustainable Development Goals

   The enactment of this regulation, on July 4, 2017, is one of them to fulfill the government's commitment to achieving the Sustainable Development Goals or SDGs (sdgs.bappenas.go.id). This Presidential Regulation is also intended to follow up on the agreement in *Transforming Our World: The 2030 Agenda for Sustainable Development* to end poverty, improve public health, promote education, and combat climate change. Perpres 59/2017 reflects the Indonesian government's commitment to integrate and achieve the SDGs in national development. It is expected that this Perpres can provide direction and coordination in the implementation of programs, activities and budgets related to the achievement of SDGs.

c. OJK Regulation Number 57/POJK.03/2017 concerning the Implementation of Good Corporate Governance Principles for Issuers or Public Companies

   Financial Services Authority (OJK) Regulation Number 51/POJK.03/2017 is an OJK Regulation that regulates the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies in Indonesia (ojk.go.id). This policy began to be implemented since July 27, 2017, made for the banking sector, focusing on the application of sustainable finance principles and green taxonomy in the financial industry. There are two points of improvement for the sustainable finance policy, namely procedural and quality. Procedurally, banks have fulfilled their obligations in implementing sustainable finance according to POJK 51/2017. However, in terms of the quality of disclosure, it is still not good enough. The implementation of sustainable finance needs to be carried out using the principles of responsible investment; sustainable business strategies and practices; social and environmental risk management.

d. ESG: POJK No. 14 of 2023 on Carbon Trading through Carbon Exchange

This regulation issued by OJK is part of the mandate of Law No. 4 of 2023 on Financial Sector Development and Strengthening (P2SK Law) which mandates further regulation of Carbon Trading through the Carbon Exchange (ojk.go.id). The Carbon Exchange POJK was established to serve as a guideline and reference for Carbon Trading through the Carbon Exchange implemented by market organizers. Its presence is to support the government in implementing climate change control programs, in line with the *Paris Agreement* commitment.

Application of Utilitarianism in ESG pillars

Utilitarianism, one of the fundamental ethical approaches, asks, “What actions should be taken for a good and happy life?” It starts with that question and uses benefits as the measure that determines the value of an action (Good, 2011 in (Mumcu, 2024)). The application of utilitarianism in the ESG (Environmental, Social and Governance) pillar emphasizes the maximization of benefits and minimization of losses for as many stakeholders as possible who are affected by a company's actions or policies.

a) *Environmental* Pillar

Utilitarianism encourages companies to consider the environmental impact of the decisions they make. Relevant to the policies associated with the Indonesian government, the value is embedded in policies that support environmentally friendly projects as well as policies that mandate industries to reduce their negative impacts on local ecosystems.

b) *Social* Pillar

Utilitarianism argues that companies should create safe, healthy, and fair workplaces for their workers. In addition, Utilitarianism opposes actions that violate human rights, such as forced labor, discrimination, and environmental destruction that prevent people from having a healthy environment.

c) *Governance* Pillar

Utilitarianism encourages businesses to apply good governance principles, such as transparency in decision-making and accountability to stakeholders.Investors tend to go for companies that are respectable in governance, have independent boards, and set up strict rules.

Critical Perspectives on ESG-related Government Policies

A critical perspective seeks to explore power imbalances, political-economic structures and who gains or loses from government policies (Gray et al., 1996). In the context of ESG-based investment in Indonesia, this perspective will question whether government policies that support ESG actually drive substantial changes in environmental, social and economic governance, or merely reinforce the status quo that benefits certain elites. A critical perspective would also evaluate whether the policies are effective in protecting the rights of marginalized communities or vulnerable natural environments or whether they are merely a response to international pressure without thorough implementation. For example, many companies in Indonesia are implementing ESG policies due to demand from foreign investors, rather than a commitment to sustainability. This leads to an imbalance in implementation, where multinational companies are more oriented towards investor interests than the welfare of local communities or environmental preservation. (Holdaway, 2019) states that social and environmental policies are often undemocratic in their decision-making process, which causes them to not reflect the needs of society.

The focus on ESG issues is mostly on foreign investors, but based on the latest data from PT Kustodian Sentral Efek Indonesia (KSEI) the number of foreign investors in Indonesia has decreased considerably. According to KSEI's official report on Monday (21/11/2022), the number of capital market investors referring to the Single Investor Identification (SID) reached 10,000,628 on November 3, 2022, with the composition of local investors at 99.78 percent. This is an increase of 33.53% from 7,489,337 at the end of 2021 to 10,000,628 on November 3, 2022. This trend has increased since 2019, when investors still amounted to the ownership of local investors in capital market investment instruments, both shares and other securities registered in the KSEI system, showing the dominance of local investors. In addition, this trend contradicts the trend of the previous five years, when foreign investors dominated 70% of the value of stock transactions, and local investors dominated the rest. According to him, changing the perspective and focus of investors who mostly focus on the bottom line rather than ESG will be a challenge. Political realities show that economic dominance over environmental issues is becoming increasingly pervasive with the increasingly strong position of capital owners. As long as this condition has not changed, environmental considerations will still remain in the gray area and hopes for sustainability will stop at mere discourse (Muthmainnah et al., 2020)

Pragmatically epistemology demands a critical review of who benefits from ESG-based policies and whether the values are actually implemented with integrity or simply as a form of "*greenwashing*" (green branding efforts without substantial action). Some research points to the possibility that ESG policies can be misused to enhance corporate credibility without prioritizing real solutions to social and environmental problems. According to (Deegan & Blomquist, 2006), ESG-based investments are linked to the drive for "social legitimacy", where companies use environmental policies. Companies may view ESG as a means to meet the expectations of society and influential stakeholders, ultimately influencing government policies and industry standards. Undoubtedly, ESG implementation must start with good corporate governance. If governance is made wisely and in accordance with applicable regulations, environmental and social aspects will follow suit. Therefore, corporate governance must comply with regulations set by the government or regulators.

In the *utilitarianism* concept, it is used as a tool to measure the impact of ESG-based economic and investment policies where utilitarianism emphasizes the consequences of an action. According to the concept of utilitarianism, cost-benefit analysis is used to measure the impact of ESG-based economic and investment policies on people's welfare and consider the positive and negative impacts of the policy on various groups of people, and identify whether the policy maximizes benefits for the majority. When associated with the values of Pancasila as a *moral compass* in the application of utilitarianism, Pancasila values such as humanity, unity, and justice, can be an ethical guide in applying the principles of utilitarianism, namely ESG-based economic and investment policies not only maximize happiness but also uphold human values and justice.

5. CONCLUSION

Sustainable development shall offer solutions to meet people's basic needs, combine development and environmental protection, achieve equality, ensure the establishment of social life and cultural diversity and protect ecological integrity in an economic context. (P. N. Sari & Khomsiyah, 2023) ESG policies in Indonesia, while promising in terms of creating more sustainable investments, still face many challenges. Epistemological perspectives and critiques of greenwashing suggest that the implementation of these policies is often focused more on legitimacy than real impact. Transparency and accountability should be prioritized in ESG reporting so that these policies actually bring about substantial change, rather than just serving as an image strategy. On the other hand, the policy should also be more inclusive, paying attention to small businesses that may not have the capacity to comply with ESG standards.

Through an epistemological perspective, we can assess the extent to which ESG policies in Indonesia are based on a deep understanding of environmental, social and governance impacts, and how consistently these values are applied in complex local contexts. Through strengthening policies, institutions and supporting tools, increasing GHG emission reduction targets and strengthening climate change adaptation commitments through the implementation of ENDC, Indonesia can better address climate change impacts at the national level and contribute to the global level.

6. LIMITATION

This research has several limitations that can be used as further research opportunities in the future. This research uses secondary data such as policy documents, government reports, and academic publications. The lack of primary data from interviews, surveys or direct observations may limit the depth of analysis and relevance to field conditions. This research discusses ESG in the general context of Indonesia but does not accommodate variations between industry sectors or regions.

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