CHAPTER I

INTRODUCTION

A. Background

Nowadays, almost all countries and nations actually make economic development a measure of the performance of the country. The government always tries to rises the economic growth of a country from year to year in order to enhance the welfare of the society. One measure of economic growth is national income. The national income of a country might indicate the overall level of economic activity. National income is a term that is frequently used to refer to a measure of economic growth, but it is not the only indicator of economic growth. Boediono (1999) defines economic growth as a as a process of increasing output per capita in long period of time. When a country's economic growth improves, it means that economic operations have also improved which resulting in enhanced goods and services generated in the region, and increased community wealth.

The economy is considered to be experiencing growth if all real remuneration for the use of production factors in a certain year is greater than the real income of the community in the previous year. According to Neo-Classical Economic Growth Theory, economic growth (as measured by GRDP growth) is dependent on the development of production elements such as capital, labor, and technology (Sukirno, 1994: 456). This means that the larger the amount or influence exerted by the factors of production, the greater the economy of a country will grow.

The calculation of GRDP has become a very important part of macroeconomics, especially regarding the analysis of the economy of a region. The results of this GRDP calculation provide the basic framework used to measure economic activity that occurs and takes place in an economic activity. The GRDP serve as macroeconomic indicators and also serve as a basis for evaluating economic performance and formulating various policies.

Gross regional domestic product (GRDP) is a measure for economic progress in a region. The Gross Regional Domestic Product (GRDP) is the net value of final goods and services produced by various economic activities in a given area during a certain time period. The increase in GRDP will result in an increase in government revenues, which will be used to finance development activities. Then it will improve local government services to the community which is expected to increase the productivity of its performance. The pace of economic development is expected to be a point of success for regional autonomy in the form of regional development that has been achieved and is useful for determining future decisions (Nandita et al., 2019).

Economic development has long been a part of the classic discourse of Muslim philosophy, and it is referenced in the Qur'an's Surah

Hud verse 61, where it is referred to as "prosperity of the earth," which is an interpretation of Allah's word.

...هُوَ أَنشَأَكُم مِّنَ لْأَرْضِ سْتَعْمَرَاَوَ كُمْ فِيهَا سْتَغْفِرُفَاْ هُو ثُمَّ بُوَتُو اْ إِلَيْهِ...... (هود:٦١)

Meaning:

He has raised you from the earth and settled you in it, enabling your dignity and prosperity. So, ask forgiveness of Him (for the sins you have so far committed) and turn to Him repentant. (Q.S Hud: verse 61).

The term "land prosperity" reflects an idea of economic progress, as Ali bin Abi Talib stated to an Egyptian governor: "You should prioritize the prosperity of the land over the tax collection orientation, because revenues can only be optimized through the prosperity of the land." Whoever collects taxes without respect for the land's prosperity will destroy the country.

Labor is believed to have an impact on a region's economic development. An increase in labor that is balanced by the rise in output produced can help the region's economy grow. Labor generates demand in order to generate economic activity, which means that by adding labor, demand will increase, and increased demand will be able to stimulate additional economic activity. Additionally, it may boost capital need to compensate for the rise in production activity. Thus, an increase in labor will raise demand for capital and stimulate economic activity, which is predicted to enhance the rate of economic growth. The increased number of workers will enable a region to increase its output of products and services required by the community (Sukirno, 2008: 430).

Lewis developed his employment theory, which stated that extra labor is an opportunity rather than a problem. Excess workers in one sector will contribute to output growth and the supply of workers in other sectors. Lewis further said that the economy of developing countries is divided into two sectors: the modern sector and the traditional sector. The traditional sector is not only the agricultural sector in rural areas, but also includes the informal sector in urban areas (street vendors, retailers, angkringan traders). Because the informal sector is capable of absorbing excess labor created by industrialization, it is referred to as the labor safety valve. With the informal sector absorbing extra labor in the industrial sector (modern sector), rural wage levels will eventually increase. This increase in wages will narrow the income disparity between rural and urban areas, ensuring that the excess supply of labor does not disturb economic progress. An increase in the labor force has traditionally been regarded as one of the positive factors that contribute to economic growth; a greater number of workers equates to an increase in the level of production; and an increase in the level of production equates to an increase in the level of employment (Todaro, 2000:112).

Aside from labor, investment is thought to be one of the variables influencing regional economic growth. According to Harrod-Domar, investment is necessary for growth because it represents a net addition to the capital stock (Todaro, 2011:199). Investment is generally recognized as a critical term in any discussion of economic principles. Given that the consumption-driven economy is seen as very fragile, the language of economic growth, creation of jobs, and poverty alleviation ultimately places investment as the major factor (Nuryadin, 2005).

Investment is a significant role in determining economic development. With new investments, it is feasible to develop new capital goods that will absorb new factors of production, namely establishing new jobs or employment opportunities that will absorb labor, thereby reducing unemployment. With the new investments, there will be more output and income in these factors of production, so that it will stimulate economic growth (Todaro, 2004). According to Rizky et al. (2016) research, investment has a significant effect on economic growth. This suggests that more investment, both foreign and domestic, has the potential to result in significant economic development.

Investment can be classified into two categories: Domestic Investment (PMDN) and Foreign Direct Investment (FDI). According to Ghou and Soumaru (2012), FDI must be properly planned in order to lead foreign investment towards productive economic sectors, which will result in the creation of jobs for local people and the development of their skills.

Table 1.1 The Development of Investment in Indonesia 2015-2019

Years	Domestic Investment		Foreign Direct Investment	
	Project	The Value of Investment (Trillion Rupiah)	Project	The Value of Investment (Trillion Rupiah)
2015	5.100	179,5	17.738	403.86
2016	7.511	216,3	25.321	389.16
2017	8.838	262,3	26.257	436.78
2018	10.815	328,8	21.972	424.41
2019	30.451	386,5	30.354	392.13

Source: BKPM and BPS 2020

As shown in Table 1.1, the realization of the investment value of Domestic Investment (PMDN) in Indonesia increased year on year from 2015 to 2019, reaching a record high of IDR 30,451 trillion in 2019. Meanwhile, the growth of Foreign Direct Investment (FDI) is inconsistent. The largest inflow of FDI happened in 2017, reaching Rp 436.78 trillion. In 2019, investment realization climbed from 10.815 into 30.451, while the economic growth increased to 5, 02% the following year. This graph demonstrates that increasing investment has a positive influence on increasing economic growth. Meanwhile, the amount of FDI and Domestic Investment projects has fluctuated throughout the last few years.

Along with labor and investment, capital is a very important production factor in determining the level of national income or GDP (Gross Domestic Product). However, it is sometimes misunderstood that a country's economy will be unable to expand at all if it does not have access to sufficient capital. Capital is, without a doubt, significant, but it is not the sole element that affects the rate of economic growth. Growth will occur even with a small amount of capital, as long as the country's people in question have a strong desire to see it happen (Suparmoko, 1998).

Capital accumulation occurs when a portion of one's income is saved or reinvested in order to increase output and income in the future. This capital accumulation is undertaken not only by the government, but also by the private sector. It is critical to recognize the function of capital accumulation by both the government and the private sector. Capital accumulation, also known as investment, is crucial in pushing the nation's economic life forward since capital creation can enhance production capacity, national income, and create new jobs, all of which will boost job prospects (Todaro and Smith, 2006).

The form of government expenditure in the form of capital expenditure allocation for the provision of various public facilities and infrastructure that can become regional fixed assets and has a useful value of more than one year is expected to be capital to support the implementation of various community economic activities. In addition, the problem of government spending, especially capital expenditures so far has not received serious attention from the government both at the center and in the regions so that in the future, it should be more intensively considered and prioritized, because in fact, so far the government budget has a larger portion for personnel expenditures than capital expenditures. This has resulted in regional development not having a significant impact on improving the welfare of the community and the lack of quality of public services.

Economic growth in Indonesia certainly cannot be separated from contributions from various provinces, residency, districts/cities, etc. Central Java Province is one of the provinces that contribute greatly to the gross regional domestic product of Indonesia. Each province in Indonesia, including Central Java Province, must be able to face global economic challenges, such as achieving high economic growth and overcoming development problems that arise, particularly during the reform era when each region has the greatest freedom to manage regional wealth that is owned and used for development activities in the area.

Gross Regional Domestic Product (GRDP) is an indicator that may be used to determine a region's future development direction and can be used to measure the success of development that has already been achieved. The development of economic on Central Java Province can be seen from Table 1.2

Table 1.2 Gross Regional Domestic Product at 2010 Constant Market Prices by Industry in Central Java Province (billion rupiah), 2017-2019

No	Sector/ Industry	2017	2018	2019
1	Agriculture, Forestry, and Fishing	118.450,17	121.556,54	123.214,20
2	Mining and Quarrying	20,356,48	20.855,98	21.557,12
3	Manufacturing	308.770,22	322.200,87	338.937,67
4	Electricity and Gas	976,55	1.028,92	1.085,27
5	Water Supply; Sewerage, Waste Management, and Remediation Activities	628,21	658,88	687,98
6	Construction	92.762,02	98.292,74	103.262,32
7	Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles	129.133,51	136.588,14	144.758,38

8	Transportation and Storage	29.867,33	32.121,01	34.848,12
9	Accommodation and Food Service Activities	28.350,13	30.667,22	33.469,95
10	Information and Communication	40.485,50	45.500,92	50.789,28
11	Financial and Insurance Activities	24.749,92	25.635,55	26.535,01
12	Real Estate Activities	16.856,96	17.797,50	18.782,40
13	Business Activities	3.296,66	3.609,30	3.989,82
14	Public Administration and Defence; Compulsory Social Security	23.304,54	24.137,86	25.033,50
15	Education	33.674,59	36.286,32	39.040,75
16	Human Health and Social Work	7.525,67	8.187,91	8.738,37
17	Other Services Activities	24.561,84	15.937,47	17.375,66
	GRDP	**893.750,30**	**941.164,12**	**992.105,79**

Source:BPS-Statistics of Central Java 2020

Table 1.2 shows that there was an increase in Gross Regional Domestic Product every year. Naturally, the increase in gross regional domestic product of every year comes from the contributions of various residencies, regencies, and cities located in Central Java Province. The Semarang Residency is one of the residences that greatly contribute to economic growth in Central Java Province.

The Residency of Semarang is a unitary area of the Republic of Indonesia located in Central Java Province. The Semarang Residency area consists of 4 regencies and 2 cities, namely Semarang Regency, Kendal Regency, Demak Regency, Grobogan Regency, Semarang City and Salatiga City. The contribution given by each Regency/City in the Residency of Semarang to the Gross Domestic Regional Product of Central Java Province can be seen in Table 1.3

Table 1.3 Gross Regional Domestic Product at Constant 2010 Prices of Semarang Residency (billion rupiah), 2018 − 2020

No	Regency/City	2018	2019	2020
1	Semarang Regency	33.817,68	35.639,31	34.687,62
2	Kendal	29.245,66	30.916,39	30.443,69
3	Demak	17.479,88	18.417,01	18.374,56
4	Grobogan	18.688,57	19.692,63	19.379,68
5	Semarang City	131.266,40	140.209,40	137.951,30
6	Salatiga	9.127,86	9.666,01	9.503,16
	Total	239.626,05	254.540,75	250.340,01

Source:BPS-Statistics of Central Java 2021

Table 1.3 shows that the GRDP of the Residency of Semarang has fluctuated in the last 3 years. In 2019, the GRDP of the Residency of Semarang increased from 239,626.05 in 2018 to 254,540.75. Meanwhile, in 2020, every Regency/City in the Residency of Semarang experienced a decline in GRDP to 250,340.01. This fluctuation is undoubtedly linked to the different factors that influence economic growth in Semarang regencies, such as labor, technology, capital, natural resources, and so on.

Kholifia et al. (2021), found out that labor along with number of industries, general allocation funds, local revenue, profit-sharing fund and open unemployment rate have a positive and significant effect on GRDP. Furthermore, Nandita et al. (2019) in their research also find out that an increase in total population from year to year can significantly influence GRDP in a positive way. They also discovered investment has a positive and significant effect towards Gross Regional Domestic Product (GRDP).

In contrast to Kholifia et al. (2021), who discovered that labor had a positive effect on economic growth, Wahyudi and Yuliadi (2013) discovered that labor has a negative and significant effect; increasing the labor force by about 1% results in economic growth decreasing by -0.67 in each DIY region. Additionally, they discover that domestic investment, foreign direct investment, and domestic government spending all have a large positive effect on economic growth.

According to the findings of Hakim and Subanti (2019), only investment has a positive and significant impact on economic growth and development in Central Java Province. While the labor force and the length of time spent in education have an ambiguous relationship with economic growth. Meanwhile, Prawoto and Basuki (2020) identified a positive relationship between household and government consumption toward economic growth in Special Region of Yogyakarta. This implies that increasing consumption will result in higher demand for goods and services, and that increased demand will result in increased production of goods. Additionally, they discovered in their research that the Human Development Index (HDI) had a negative impact on economic growth. Because of the high expense of education and health care, an increase in HDI actually prevents economic progress.

Hapsari & Iskandar (2018) in their research also find out that an increase in private investment from year to year can significantly reduce economic growth. They also find out that an increased in capital expenditures and health facility are insignificant to economic growth. From the previous research, it can be concluded that there are several factors that have a significant effect on economic growth, but there are also several factors that do not significantly affect economic growth.

Based on previous research, there have been many studies on various factors that affect economic growth in various provinces, residencies, districts/cities in Indonesia. However, there was still little evidence showing the factors that influence economic growth in the Semarang Residency. Furthermore, from the previous researches mentioned above, it can be used as a reference to determine whether the economic growth of Semarang Residency in Central Java Province is also influenced by the factors mentioned above. Therefore, researcher are interested in researching the influence of several factors, namely Labor, Capital Expenditure, and Investment on economic growth by taking a case study of the Semarang Residency in Central Java Province (2016-2020).

This thesis will especially cover "**Analysis of Gross Regional Domestic Product (GRDP) Determinants in the Semarang Residency of Central Java Province**" in light of the background and research gaps.

B. Formulation of Problem

Based on the background, this research specifically addresses these following questions:

1. How is the influence of Labor on GRDP in the Semarang Residency?
2. How is the influence of Capital Expenditure on GRDP in the Semarang Residency?
3. How is the influence of Investment on GRDP in the Semarang Residency?

C. Purpose of Research

Based on the research questions above, the purpose of this research are:

1. To analyze the influence of Labor on GRDP in the Semarang Residency (2016-2020).
2. To analyze the influence of Capital Expenditure on GRDP in the Semarang Residency (2016-2020).
3. To analyze the influence of Investment on GRDP in the Semarang Residency (2016-2020).

D. Benefits of Research

The following are some of the benefits gained from this research:

1. For the author, as one of the requirements for completing the final project and obtaining a bachelor's degree in the International Program of Islamic Economic and Finance at Universitas Muhammadiyah

Yogyakarta and adding insight and knowledge in order to develop the knowledge gained during lectures at the Faculty of Economics and Business, Universitas Muhammadiyah Yogyakarta.

2. Other researchers, as library materials, information and references as well as suggestions for further research related to the theme of this study.
3. The government and related parties, as input and information for the Central Java Provincial government in planning and making decisions and economic policies.