

CHAPTER I

INTRODUCTION

1.1. Background

Economic growth is a process of changing the condition of a country's economy on an ongoing basis towards a better condition for a certain period. Economic growth is an increase in Gross Domestic Product (GDP), either in the form of a significant/increase in GDP or less than the rate of population growth (Arsyad, 2004). Economic growth is defined as a rise in an economy's ability to generate goods and services that advance the welfare of its citizens (Adamu, Jibir, & Hajara, 2015). Economic growth is an indicator that is generally used to see the success of the economy in a region. It measures the output and development of an economy from time by time. Economic growth is influenced by two main factors, namely total output growth (GDP) and population growth according to Adam Smith (Boediono, 1999). According to Todaro (2000), there are three main factors that affect a country's economic growth, namely population growth, capital accumulation and technological progress. There is the ideal economic condition where the ideal economy is an economy that continuously grows without one year or even one quarter experiencing a decline.

Indonesia is a developing country which is in the take-off stage where economic growth is quite high. According to the data, Indonesia has the highest economic growth rate in ASEAN in the last five years. Indonesia's economic growth has experienced instability over the past five years, starting from 2017 to 2021. There has often been a decline in the rate of economic growth, especially in the 2020 period where in this year, Indonesia's economic growth rate touched -2.07 which was a significant decline from the previous year of 5.02, this was due to the covid-19 pandemic throughout the world where almost all countries were affected by this pandemic.

Indonesia is a country with the largest economy in ASEAN. Based on the data published by World Bank data, Indonesia's gross domestic product (GDP) will reach US\$1.19 quadrillion in 2021. When compared to 9 other ASEAN countries, this was the largest value. This figure reaches one-third of the total ASEAN's GDP with a total value of US\$3.34 quadrillion. If we take a look from the percentage rate of economic growth, the percentage rate in Indonesia recorded a growth of 5.72 percent last year which is in fourth place among three other countries under Malaysia, Vietnam and Philippines.

Human resources are one of the elements of development that can support the progress of a country. With quality human resources, it will greatly assist the management of wealth owned by a country. According to Adam Smith (Prida, 2011) states that humans are the main factor that determines the prosperity of the nation. The reason is that nature (land) is meaningless if there are no human resources who are good at processing it. In other words, human capital is one of the determining factors in increasing economic growth. According to Todaro (2000) there are three main factors that affect a country's economic growth, namely capital accumulation, population growth and technological progress. According to Becker (1962), investment in human capital is related to all activities that affect a person's real income in the future through an increase in human resources.

The role of government as a driving force for progress is vital in supporting the advancement of people's welfare and the development of state finances. In increasing the development of resources in order to increase economic growth, government commitment is required. The government's commitment to building quality or social welfare in a country can be seen through the allocation of government spending in some sector, for example education spending, health spending, infrastructure spending and so on. Simon Kuznets states that a country's financial development is influenced by the accumulation of capital (arrival speculation, hardware, framework and offices and human assets), normal assets, human assets, both the number and quality of the population, innovative drive, to data, the desire to improve and create self and work culture (Todaro, 2000).

As a form of government fiscal policy, every year the central government stipulates the State Budget Law (UU-APBN) as the government's right and commitment in carrying out development. Meanwhile, the regional government annually stipulates a regional regulation concerning the Regional Revenue and Expenditure Budget (APBD) in accordance with the development policies of each region. This is in accordance with the spirit of regional autonomy which has come into force since the issuance of Law Number 22 of 1999 concerning Regional Government. Judging from its purpose, central government spending can generally be divided into two groups. First, government spending which directly contributes to human resources development. Second, government spending to increase production capacity and maintain sustainable economic growth. To achieve this goal, all economic activities require adequate facilities and infrastructure, so that government spending is usually allocated to improved infrastructure.

The Indonesian government considers people-centered development more important than anything else. The government prioritizes the education budget at least 20% of the APBN and APBD of the total budget, and for the health budget at least 5% of the total APBN budget and 10% of the total APBD budget. In the Indonesian government spending budget from 2017 to 2021 from the data that was published on BPS, it can be seen that this budget is used for various types of realization of government spending in increasing the provision of funds in building education, health and also the country's infrastructure. Increased infrastructure development throughout Indonesia can overcome waves of unemployment, such as roads, bridges, ports, docks, energy, transportation, housing, education and health facilities.

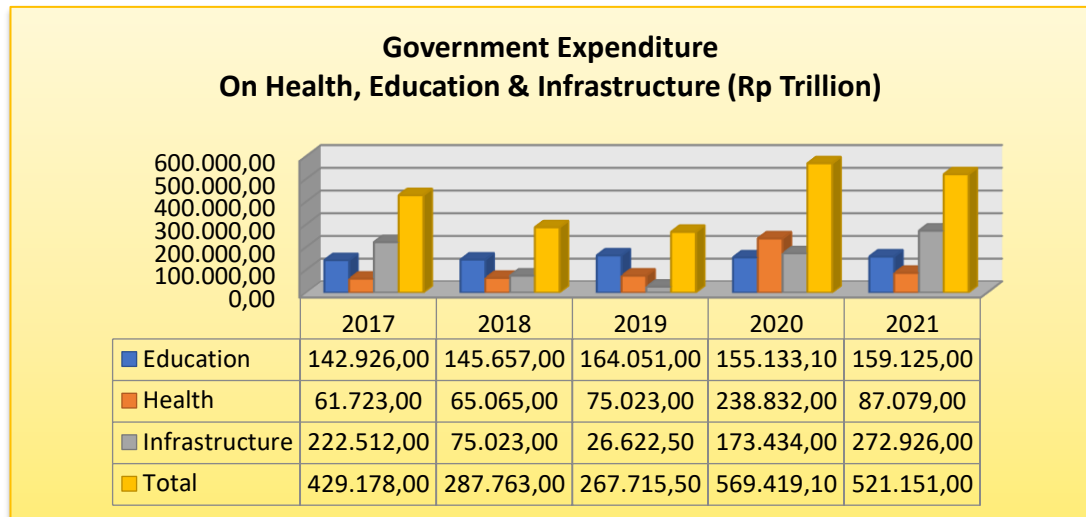


Figure 1. 1 Government Expenditure on Education, Health & Infrastructure of Indonesia in 2017 – 2021

Source : Kemenkeu website

Based on figure 1.3 above shows the Indonesian government expenditure shows in figures 1.3 for the 5 year period (2017-2021) there has been a decrease and increase in the amount of Indonesian government spending. At the beginning of 2017, government spending amounted to \$168,189.00 billion, then increased again in subsequent years until 2021 which was quite high. In 2021, the highest government spending figure in the last five years is \$216,238.5 billion. The amount of government spending on the education sector in the last five years has increased quite steadily, while in the health sector the government expenditure figures have experienced instability until 2020 and then increased drastically in 2021, this is because it is in accordance with the Government's focus on handling the pandemic in Indonesia. In government expenditure on infrastructure data there has been an increase from year to year, but not so significant in 2020 due to a reduction in allocations by the government.

To increase economic growth, investment is also needed in addition to human resources. The government or the business sector can equally invest. Investment is an important indicator for economic growth. Investment plays a role in economic recovery and is positively correlated with the country's infrastructure development. Investment either directly or indirectly consumes labor and generates

money. Increasing the productivity of capital and labor can accelerate output growth and increase people's income and wealth. An increase in national income or GDP will support the government's development efforts. In this context it can be translated into two variables, namely Domestic Investment (DI) and Foreign Investment (FDI). Domestic Investment is defined as business investment in the territory of the Republic of Indonesia carried out by domestic investors using domestic capital.. Whereas Foreign Investment in the form of capital flows into Indonesia from abroad to the private sector can be through direct investment or indirect investment or commonly called portfolio.

Based on data published by the Central Bureau of Statistics, the realization of PMDN in the last five years (2017-2021 period) has experienced a significant increasing trend, where the realization rate has on average exceeded the targets set in the National Medium Term. Development Plan (RPJMN). Meanwhile, FDI realization data that occurred in the last five years experienced a significant decline until 2019 and increased again in 2020 and 2021.

Investment is an important indicator for economic growth. Through investment, it can have a positive impact on all forms of production processes in various businesses that are increasingly active as investment increases, and will also have an impact on increasing household consumption. Investment plays a role in economic recovery and is positively correlated with the country's infrastructure development. An increase in national income or GDP will support the government's development efforts. In this context it can be translated into two variables, namely Domestic Investment (DI) and Foreign Direct Investment (FDI). Based on the Indonesian Investment Law, Domestic Investment is defined as business investment in the territory of the Republic of Indonesia carried out by domestic investors using domestic capital. Whereas Foreign Investment in the form of capital flows into Indonesia from abroad to the private sector can be through direct investment or indirect investment or commonly called a portfolio.

Based on data published by the Central bureau of statistics, the realization of domestic investment in the last five years (period of 2017-2021) has experienced a significant increasing trend, where the realization rate is on average able to exceed

the target set in the National Medium Term Development Plan(RPJMN). Meanwhile, data on the realization of foreign direct investment that occurred in the last five years, there has been a significant decline until 2019 and increase again in 2020 and 2021. This shows that domestic and foreign investors are increasing confidence in government policies in the investment sector in the post pandemic (Bahlil Lahadalia, 2022).

1.2.Research Problem

Based on what has been described in the previous background, there are several forms of problem formulation that can be taken as research topics to be carried out. Based on data from the World Bank, Indonesia occupies the highest position as a country with the largest economy in ASEAN. Indonesia's gross domestic product (GDP) will reach US\$1.19 quadrillion in 2021. When compared to 9 other ASEAN countries, this is the largest value. This figure reaches one-third of ASEAN's GDP with a total value of US\$3.34 quadrillion. However, when viewed from the percentage of economic growth, Indonesia is still below several other ASEAN countries, namely Malaysia, Vietnam and the Philippines. Where Indonesia's growth percentage recorded a growth of 5.72% in fourth place under Malaysia with a growth percentage of 14.2% in the first position, the second position was Vietnam with a percentage of 13.67%, then in third place was the Philippines with a growth percentage of 7.6%.

From the various studies that have analyzed this topic, there are still differences in findings; there some find that government expenditure has a positive impact on the economy while some also find a negative relationship between these two. Several problem formulations might be suggested in order to describe the issues in this study:

1. Does investment in human resources in the form of government spending on education & health contribute to Indonesia's economic growth?
2. Does government expenditure on the infrastructure sector have an impact on Indonesian economic growth?

3. Does the Investment in the form of foreign direct investment have an impact on Indonesia's economic growth?
4. Does the Investment in the form of domestic investment have an impact to Indonesia's economic growth?

1.3. Research Objective

According to the explanation of the problems above, the objectives to be achieved from this research are:

1. To determine the impact of government spending on education & health sector on Indonesian economic growth rate.
2. To determine the impact of government spending on infrastructure sector on Indonesia's economic growth
3. To determine the impact of foreign direct investment to the economic growth in Indonesia.
4. To determine the impact of domestic investment to the economic growth in Indonesia.

1.4. Research Advantages

The usefulness of this research is:

1. The findings of this study can help researchers better understand how the government budget or government spending affects economic growth and how each country can get through a crisis or pandemic to improve MSME performance.
2. For policy makers, this research is expected to be a source of information about developmental conditions and Indonesia's position in regional economic growth as well as factors that increase economic growth so as to maximize economic growth and achieve the goal of increasing people's welfare.

3. For academics, especially in the field of economics, it is hoped that this can become reference material for conducting further research in related matters

4. For the author, as one of the requirements that must be fulfilled to obtain a bachelor's degree in Economics (S1) at Andalas University.

1.5 Systematic Writing

This systematic seeks to provide a comprehensive overview of this research. The systematic writing that follows:

Chapter I: Introduction

In the introductory chapter there are five sub-chapters, namely: background, research problems, research objectives, research advantages and writing systems.

Chapter II: Literature Review

This chapter includes a review of the literature that backs up and connects to the variables researched, which is reinforced by earlier work that connects to the study's title and premise.

Chapter III: Research Methodology

This chapter includes the definition of variables, types of data and their sources, sampling techniques, and a study model.

Chapter IV: Results and Discussion

This chapter presents the findings and statistical descriptive analysis from the research.

Chapter V: Conclusion and Recommendation

The conclusion and suggestions from the articles in the earlier chapters are contained in this section, which is the last section of the research.