

CHAPTER I

INTRODUCTION

1.1 Problem Identification

Labor absorption is an important indicator in assessing the economic development of a region. In 2023, the working age population in West Sumatra reach 4.34 million people. 3.02 million people of the working age population are in the labor force, consisting of 2.84 million employed people and 179.51 thousand unemployed people. This means that as many as 5.94 percent of the working age population in West Sumatra are still not absorbed into the world of work or have not yet found work (BPS Provinsi Sumatera Barat, 2023). With an Open Unemployment Rate of 5.94 percent, West Sumatra is one of the provinces with the highest unemployment rate in Indonesia. Where other provinces are already at a low level of open unemployment, namely below 5 percent (Badan Pusat Statistik, 2024).

A total of 2.84 million people working in West Sumatra Province are spread across 17 sectors/business fields. According to data from the West Sumatra Provincial Statistics Agency in 2023, there are three sectors with the highest labor absorption. The highest employment levels are agriculture with 964,493 workers, then followed by wholesale and retail trade and motor vehicle and motorcycle repair with 529,285 workers, and the manufacturing sector with 245,568 workers.

Although the agricultural sector still dominates the employment landscape in West Sumatra, there has been a shift in labor from this sector to other sectors, such as trade, services, and industry. The fluctuations in labor absorption were attributed to changes in population, net migration, output, and wages. (Sitanggang, I.R & Nachrowi, N.D, 2004)

The manufacturing industry refers to the economic activity of transforming basic goods into final or intermediate products through mechanical, chemical, or manual processes. It involves converting lower-value goods into higher-value products. This industry also encompasses services related to manufacturing and assembling (BPS Sumatera Barat, 2023).

Quoted from (Kementerian Perindustrian RI, 2020) the manufacturing industry is a production activity that involves a series of processes that change basic materials into products with higher added value. This process utilizes human resources, equipment and technology to produce various types of goods needed by society. The manufacturing sector, as one of the sectors with significant growth in West Sumatra Province, has absorbed quite a large workforce. Around 8.6 percent of workers in West Sumatra work in the manufacturing sector.

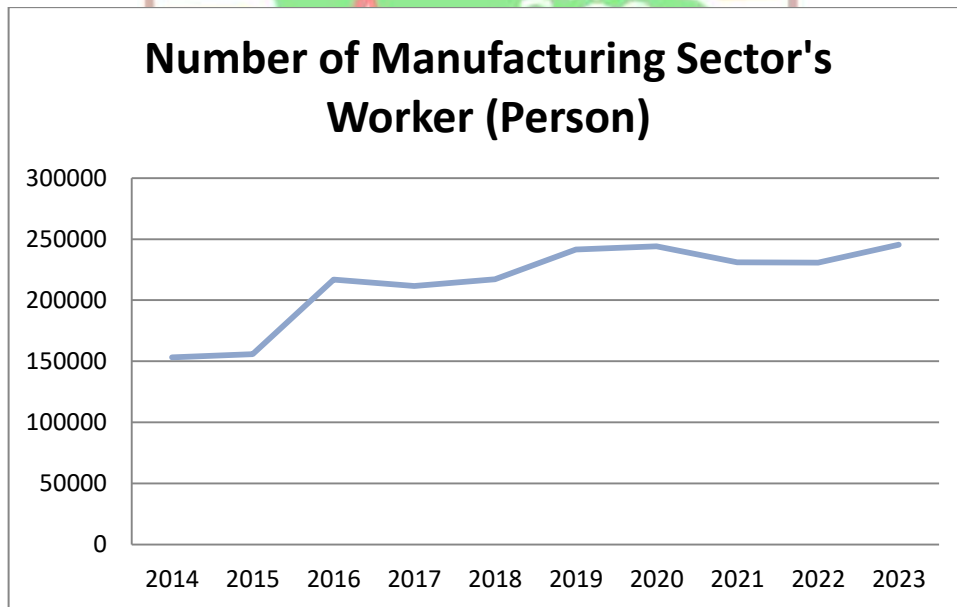


Figure 1. 1 Number of Manufacturing Sector’s Worker in West Sumatera (2014-2023)

Source: BPS

The number of manufacturing sector workers in West Sumatra shows a fluctuating trend but still increasing in general. This is due to the fact that many businesses experienced a drop in labour as a result of the pandemic. The

manufacturing sector then started to grow after the epidemic, which led to an increase in labour absorption (BPS Provinsi Sumatera Barat, 2023). If investigated further, there is also a fluctuating trend in large and medium manufacturing sector from 2019 to 2021.

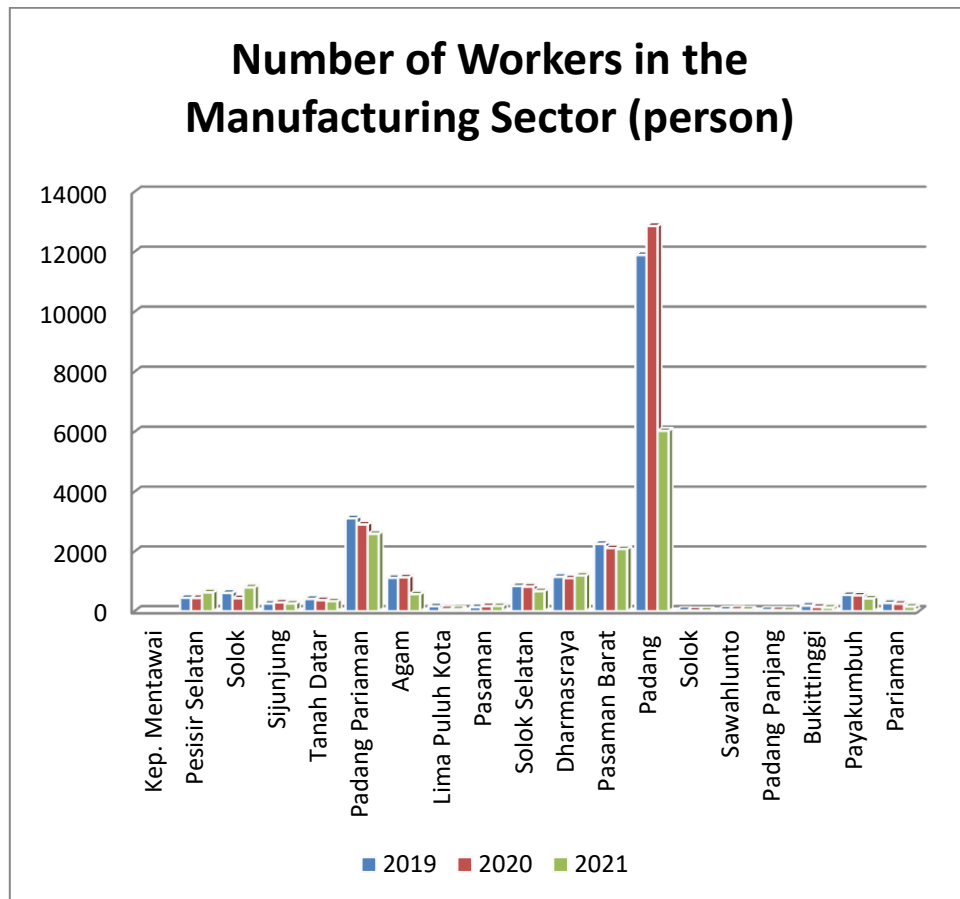


Figure 1. 2 Number of Workers in the Large and Medium Manufacturing Sector in West Sumatera (Person)

Sources: West Sumatera in Figure 2023 and 2024

Based on the graph above, the number of the large and medium manufacturing sector workers in each regency/municipality in West Sumatra from 2019 to 2021 experienced a quite fluctuating trend. The total number of manufacturing sector workers in West Sumatra in 2019 was 23,466 people, then this number increased to

23,723 in 2020. Meanwhile in 2021 it decreased to 16,143 with the largest number of workers occurred in Padang. A total of 6,828 people or more than half the initial number moved/quit the manufacturing sector due to the economic downturn caused by the Covid-19 pandemic.

The workforce distribution in large and medium manufacturing industry in West Sumatra Province's regency/municipality predominantly centers in Padang City. This is because the majority of large and medium manufacturing industrial companies are located in Padang City and are able to absorb 6,027 workers (37.34 percent) based on (BPS Provinsi Sumatera Barat, 2023).

However, upon closer inspection, it is evident that five regencies and four municipalities consistently experience a downward trend each year. Those five regencies are Tanah Datar, Padang Pariaman, Limapuluh Kota, South Solok, and West Pasaman, as well as the municipalities of Solok, Bukittinggi, Payakumbuh, and Pariaman. This persistent decline is a matter that warrants further analysis.

GRDP is a key indicator of a region's economic performance, representing the overall value of goods and services generated within that region (BPS Provinsi Sumatera Barat, 2024). An increase in GRDP is generally considered an indication of healthy economic growth, which should be directly proportional to an increase in labor absorption. The economy of West Sumatra Province in 2023 is measured based on GRDP at Current Prices (ADHB) reaching 312.77 trillion rupiah and for 2010 GRDP at Constant Prices (ADHK) reaching 191.07 trillion rupiah. The GRDP value by ADHB increased by 27.39 trillion rupiah and by ADHK it increased by 8.44 trillion rupiah or grew 4.62 percent compared to 2022. West Sumatra's economy is recovering after going through the pandemic that started in 2020.

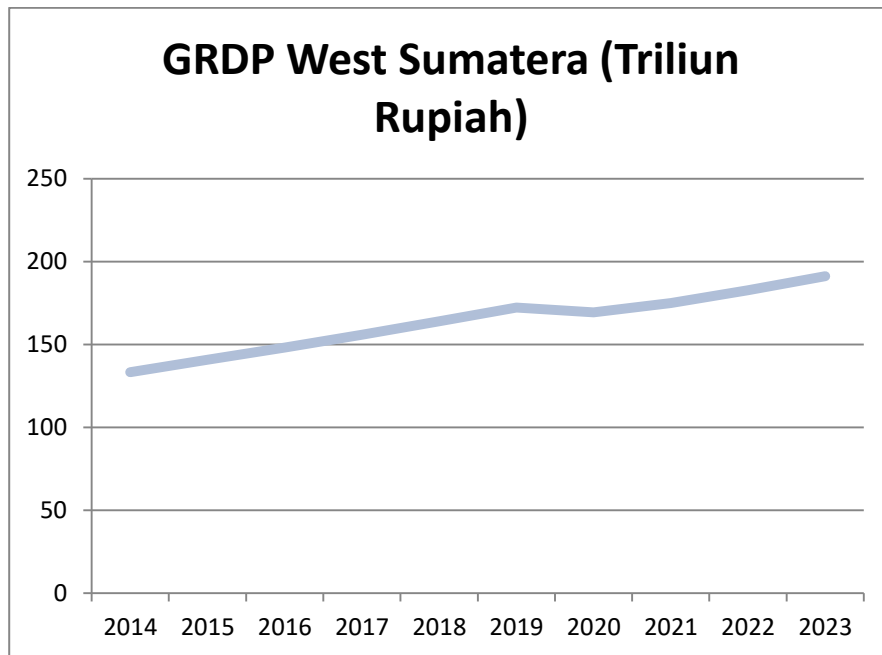


Figure 1. 3 GRDP West Sumatera Province, 2010 Constant Price (2014-2023)

Source: BPS

However, in West Sumatra, high GRDP growth is not necessarily accompanied by an increase in labor absorption. Data from Central Statistics Agency (BPS) of West Sumatra shows that West Sumatra's GRDP in 2023 reached IDR 158.3 trillion with the largest contribution from the agriculture, trade and manufacturing sectors. However, labor absorption in the manufacturing sector is still relatively low (BPS Provinsi Sumatera Barat, 2023) indicating that there are other factors that influence this dynamic.

Contribution of Business Fields

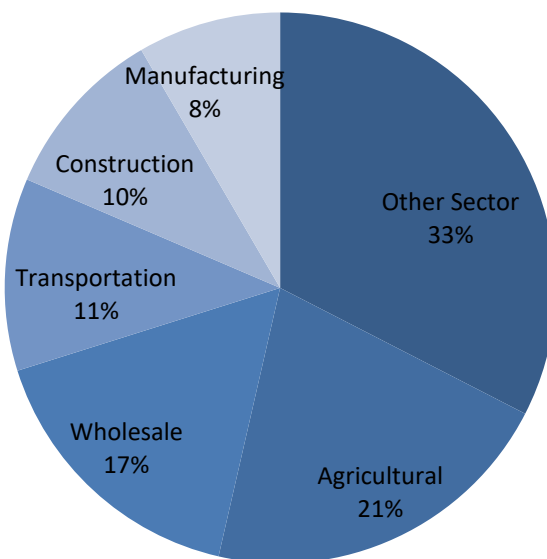


Figure 1. 4 Contribution of Business Fields to the Formation of West Sumatera's GRDP (2023)

Source: BPS, 2024

The manufacturing sector, being a major part of the industrial landscape, plays a crucial role in generating employment and stimulating economic growth in Indonesia. In West Sumatra Province, the manufacturing sector has shown quite rapid development, this is proven by the inclusion of the manufacturing industry into the 5 industrial sectors that contribute the most to GRDP in West Sumatra Province with a contribution of 8 percent. However, challenges in terms of employment in this sector are still an important issue that needs to be analyzed in more depth.

Investments are things that people or businesses buy to add to their capital share (Mankiw, Teori Makroekonomi, 2000). Theoretically, capital goods and labor are at least two of the variables of production that govern a nation's economy.

Labor provides skills, while products contribute in the form of buildings, machinery, transportation, and other capital goods. Investing also entails providing labor and capital to jointly strengthen the economy.

The level of labor absorption is not significantly impacted by the source of investment capital—domestic or international. Therefore, the capacity of an investment to absorb labor is the same whether it comes from home or international sources. Larger investments have a greater impact on labor absorption (Paramita, R. & Chritianingrum, R, 2017). Both domestic and foreign investments contribute to infrastructure development, expanding production capacity, and fostering technological innovation, all of which can enhance labor absorption.

Investment is a crucial driver of growth in the manufacturing sector. However, despite an increase in investment, particularly following the extensive infrastructure development program in West Sumatra, the impact on labor absorption has not been as significant as expected. According to data from the West Sumatra Investment and One-Stop Integrated Services Agency (DPMPTSP), total investment in the manufacturing sector reached IDR 1.5 trillion in 2023. Yet, the sector's contribution to labor absorption remains an area that requires further investigation.

Beside investment, wage is also a major factor in determining how desirable the manufacturing sector is as an employer. If wage is set too high, it can impose a burden on entrepreneurs, potentially discouraging them from hiring more workers. Conversely, if the wage is too low, it can diminish workers' purchasing power and overall welfare, ultimately affecting productivity. In West Sumatra, the average wage has seen a notable increase in recent years, reaching IDR 2.7 million per month in 2023, up from IDR 2.6 million the previous year (BPS Provinsi Sumatera Barat, 2024). This research should explore how changes in the wage influence companies' decisions to hire workers in the manufacturing sector.

Building on the above description, this phenomenon will be explored through a study that investigates the causal relationship between investment, GRDP, and average wage on labor absorption in the manufacturing sector. Accordingly, the

researcher will carry out a study titled: "**The Impact of Investment, GRDP, And Wage to Labor Absorption in the Manufacturing Sector In West Sumatera**".

1.2 Problem Formulation

Given the background information provided above, the following issues need to be looked at in this study:

- 1) How does investment affect labor absorption in West Sumatra's manufacturing sector?
- 2) How does GRDP affect labor absorption in West Sumatra's manufacturing sector?
- 3) How does wages affect labor absorption in West Sumatra's manufacturing sector?

1.3 Research Objectives

As mentioned in the problem formulation, the goals of this study are:

- 1) To understand how investment affect West Sumatra's manufacturing sector's ability to absorb labor
- 2) To understand how GRDP affect West Sumatra's manufacturing sector's ability to absorb labor
- 3) To understand how wage affect West Sumatra's manufacturing sector's ability to absorb labor