



Relevance of Investment, Economic Growth and Labor Force in Indonesia (An Empirical Analysis)

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Abstract. The role of investment critical driving economic growth, which in turn creates jobs for the labor force. The interconnectedness of investment, economic growth and labor force forms the basis of economic prosperity, as investment drives productivity and innovation, economic growth creates wealth, and a healthy labor force ensures the sustainability of development. This study aims to look at the effect of domestic investment and foreign investment in the primary, secondary, and tertiary sectors on economic growth and the labor force in Indonesia. The research period is thirteen years, from 2011 to 2023. The model used multiple regression equations. The results showed that domestic investment in the primary and secondary sectors had an influence on economic growth and for foreign investment in all three sectors had a significant effect on economic growth even though the secondary and tertiary sectors had a negative impact. Furthermore, domestic investment in the secondary sector has an influence on the labor force and foreign investment in the secondary and tertiary sectors is significant to the labor force. The increase in the Indonesian economy is strongly influenced by foreign investment when compared to domestic investment, and therefore the country needs to take some strategic steps to encourage the growth of domestic investment while maintaining healthy foreign investment flows.

Keywords: Domestic investment, foreign investment, Economic Growth, Labor Force, Indonesia

1 Introduction

Economic development requires investment support [1]. A country depends on the ability of its economic sectors to develop and attract investment. Investment activities increase the capital stock which is accompanied by an increase in productivity, capacity and quality of production, thereby encouraging economic growth and increasing the absorption of the labor force. [1].

Based on its status, the development of investment in Indonesia throughout 2011-2013 can be seen in Figure 1 that foreign investment activities are very dominant in influencing the Indonesian economy [2]. Indonesia has the highest value of foreign investment at 6.75 percent. Foreign investment growth over the past 13 years has averaged 60.38 percent while DI growth has slowed to an average of 56.67 percent.

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Therefore, the country needs to take some strategic steps to encourage domestic investment growth while maintaining healthy foreign investment flows. Furthermore, when viewed based on three sector groups, it can be seen that the tertiary sector is the main choice in investing with a growth rate of 5.28 percent, followed by the secondary sector of 5.12 percent and primary sector of 3.29 percent.

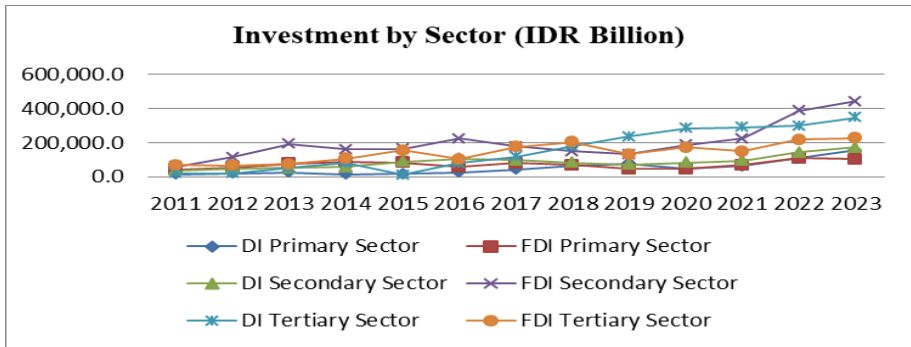


Fig. 1. Investment Realisation by Sector (Billion Rupiah)

Investment in the primary, secondary, and tertiary sectors on economic growth is mixed, with various impacts observed in different studies. Research shows that foreign investment in the manufacturing sector significantly increases economic growth, highlighting the importance of industrialization [3]. Investment in primary sectors, such as agriculture and mining, has shown mixed results. While it can contribute positively to employment, the overall impact of the primary sector on economic growth is limited [4][5]. While the tertiary sector shows a negative correlation with economic growth, especially in developing regions, where the growth of the service sector does not translate into substantial economic benefits [3][4].

Other studies have found that primary sector investment is critical for rural employment and can significantly reduce poverty rates through increased labor engagement [6]. Investment in manufacturing and MSMEs shows a strong positive correlation with labor growth [7][8]. The growth of the secondary sector is linked to improved economic conditions that drive further investment and labor demand [9]. While the tertiary sector does not directly affect employment, its growth indirectly affects people's welfare through improved economic conditions driven by primary and secondary sector investment [10].

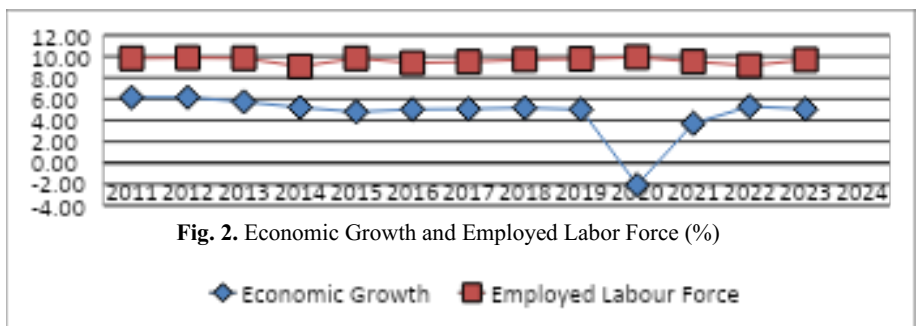


Fig. 2. Economic Growth and Employed Labor Force (%)

In Figure 2, it can be seen that national economic growth shows good development, only in 2020 economic growth deteriorates to reach -2.07 percent due to Covid-19 and then from 2021 to 2023 national economic growth is getting better until it reaches 5.05 percent, although it is slightly down from 2022 which reached 5.31 percent. Furthermore, the number of labor force absorbed in the world of work during 2011-2023 in Indonesia showed good development, also seen from an average of 94 percent of the workforce. The objectives of this study are first, to see the effect of domestic investment and foreign investment on economic growth and second, to see the effect of domestic investment and foreign investment on the labor force. For this purpose, three sector groups namely primary, secondary and tertiary sectors are taken into account in this study.

2 Literature Review

Investment plays an important role in growth theory, so it is often called the engine of growth. Investment that is capital in nature directly affects the absorption of labor so as to increase the value of national production [9]. According to Sukirno, investment aims to maximize total output at one point in time or one period of time. Capital stock or investment is one of the important factors in determining the level of national income. Investment activities allow a society to continuously increase economic activity and employment opportunities, increase national income and prosperity levels. With an increase in investment made in each region, both domestic and foreign investment will result in economic growth and an increase in the labor force.

This study identifies investment variables separately and based on three groups of sectors, namely domestic investment and foreign investment in primary, secondary and tertiary sectors, respectively, while previous studies have not conducted sectoral identification, in the sense that they still see investment based on the status or one of these sectors [11][12][13][14][15].

Economic growth has always been a hot topic of discussion in every walk of life. Endogenous growth theory emphasizes the importance of innovation, improving the quality of human resources, and capital accumulation in promoting long-term economic growth. According to Harrod-Domar in Neo-classical theory, economic growth is influenced by capital formation or investment. Increasing wealth will advance the production of goods and services, and also this theory states that capital or investment is a requirement for the country's economy to grow in the long term. Country risk proves how good and encouraging a country's situation and conditions are for conducting economic activities. If a country's country risk is high, foreign investors will have more favorable investment conditions [2]. Economic structure affects sectoral foreign investment inflows [16] as well as domestic investment provides a major role in economic development for Indonesia as a developing country with a large population [18]). Inflows of domestic investment and foreign investment boost long-term economic growth but do not affect short-term growth [17] [18].

Research on domestic investment and Indonesia's economic growth has been widely conducted including [19][20] concluded that domestic investment has a positive and significant effect on Indonesia's economic growth but research conducted

by [21][22] concluded that domestic investment is not significant to economic growth.

Research that discusses foreign investment and economic growth has been conducted by several previous researchers although it is still relatively small. Research that discusses foreign investment and economic growth includes [3][23][24] which explains that foreign investment significantly affects economic growth in 19 developing countries, but foreign investment has a negative impact on the primary sector. Secondary sector foreign investment affects economic growth significantly, [3][24] and drives growth more than service sector foreign investment [16]. Furthermore, foreign investment in the tertiary sector varies by type of activity [3] as well as [25] which says that foreign investment has no effect on economic growth in East Java.

Labor is one of the determining variables of production factors. Labor consists of two groups, namely the labor force and non-labor force [9]. The working labor force is the working age population (15 years and over) who work or have a job [26]. The number of working labor force is an illustration of the available employment conditions. Human resources are reflected in the productivity of the workforce. The greater the number of jobs available, the higher the economic growth in a country. The Solow-Swan Model theory also shows that investment in physical capital, including in the manufacturing sector, can increase labor productivity.

Research on domestic investment and the labor force conducted by [27] Domestic investment affects economic growth through employment according to [15] The sectors that have a significant effect on employment are the primary and secondary sectors but research conducted by [28] Domestic investment does not affect employment.

Research on foreign investment and labor force has been conducted by previous researchers [28] Foreign investment significantly impacts employment. [4] and [15] explain that the primary sector has a positive impact on employment, the secondary sector has a negative impact and the tertiary sector has an insignificant effect on employment while according to [6] Investment and labor have a positive impact on the growth of the manufacturing industry.

3 Research Method

This study This study was conducted for 13 years starting from 2011 to 2023. The variables used are domestic and foreign investment in the primary, secondary, tertiary sectors, Economic Growth, and Labor Force. The method used is multiple regression. In analyzing the data using eviews 12 software. The operational definitions of the variables in this study are as follows:

- Domestic Investment (DI) in the primary (X_1), secondary (X_3), tertiary (X_5) sectors is the total flow of funds or capital of domestic investors owned by all Indonesian citizens. The unit of measurement is expressed in billions of rupiah.
- Foreign Direct Investment (FDI) in the primary (X_2), secondary (X_4), tertiary (X_6) sectors is the total flow of funds or capital originating from abroad. The unit of measurement is expressed in billions of rupiah.

- Economic Growth (Y_1) is the growth rate of Gross Domestic Product in Indonesia. The unit of measurement is expressed in percent.
- Labor Force (Y_2) is the number of labor force. The unit of measurement is expressed in percent.

4 Results

4.1 Regression Equation Model

The economic growth and labor force model is based on previous research. The model is as follows.

$$\alpha_0 + \alpha_1 X_1 DI_t + \alpha_2 X_2 FDI_t + \alpha_3 X_3 DI_t + \alpha_4 X_4 FDI_t + \alpha_5 X_5 DI_t + \alpha_6 X_6 FDI_t + \mu_{0t} = Y_1 EG_t \tag{1}$$

$$\beta_0 + \beta_1 X_1 DI_t + \beta_2 X_2 FDI_t + \beta_3 X_3 DI_t + \beta_4 X_4 FDI_t + \beta_5 X_5 DI_t + \beta_6 X_6 FDI_t + \mu_{0t} = Y_2 ELF_t \tag{2}$$

4.2 Test results using the economic growth equation model

In the multiple linear regression analysis, the T-test and F-test were conducted. The results can be seen in table 1 below.

Table 1. Economic Growth model Results (PE)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.965799 0.81432	0.230098	-4.197328	0.0057
X1DI_P	1 2.50786	0.066679	12.21259	0.0000
X2FDI_P	9 1.93542	0.124984	20.06552	0.0000
X3DI_S	7 -	0.140523	13.77307	0.0000
X4FDI_S	2.710876 0.01800	0.158355	-17.11902	0.0000
X5DI_T	8	0.040321	0.446620	0.6708
X6FDI_T	-	0.126217	-20.65631	0.0000

 2.607180

$$Y_1 EG = \alpha_0 - 0.965 + \alpha_1 0.814X_1 + \alpha_2 2.507X_2 + \alpha_3 1.935X_3 + \alpha_4 - 2.710X_4 + \alpha_5 0.018X_5 + \alpha_6 - 2.607X_6 \quad (3)$$

From the equation model, it can be seen that the constant value (α_0) is -0.965, which means that if X_1 , X_2 , X_3 , X_4 , X_5 and X_6 increase by one billion rupiah, then Y_1 decreases by -0.965 percent. The table above also shows the results of multiple linear regression analysis (t-test) partially. The variable of domestic investment in the primary sector (X_1), foreign investment in the primary sector (X_2), domestic investment in the secondary sector (X_3), foreign investment in the secondary sector (X_4) and foreign investment in the tertiary sector (X_6) has a prob. value of 0.000 (<0.05), it is concluded that the five variables have an influence on economic growth. While the tertiary sector domestic investment variable (X_5) has a prob. value of 0.670 (>0.05), meaning that the variable has no effect on economic growth.

4.3 Test results using the Labor Force equation model

In multiple linear regression analysis, T-test and F-test were conducted. The results can be seen in table 2 below.

Table 2. Labor Force Model Results (AK)

Variable	Coefficien t	Std. Error	t-Statistic	Prob.
C	4.47230 4	0.022288	200.6590	0.0000
X1DI_P	0.00640 3	0.006459	0.991397	0.3598
X2FDI_P	0.02413 7	0.012106	1.993763	0.0932
X3DI_S	0.04015 7	0.013611	2.950223	0.0256
X4FDI_S	- 0.038553	0.015339	-2.513457	0.0457
X5DI_T	0.00313 6	0.003906	0.802897	0.4527
X6FDI_T	- 0.035618	0.012226	-2.913367	0.0269

$$Y_2ELF = \beta_0 4.472 + \beta_1 0.006X_1 + \beta_2 0.024X_2 + \beta_3 0.040X_3 + \beta_4 -0.038X_4 + \beta_5 0.003X_5 + \beta_6 -0.035X_6 \quad (4)$$

From the equation model, it can be seen that the constant value (β_0) is 4,472 which means that if X_1 , X_2 , X_3 , X_4 , X_5 and X_6 increase by one billion rupiah, then Y_2 will also increase by 4,472 percent. The table above also shows the results of multiple linear regression analysis (t-test) partially. The variables of domestic investment in the secondary sector (X_3), foreign investment in the secondary sector (X_4), and foreign investment in the tertiary sector (X_6), have a prob value. <0.05 , so it is concluded that the three variables have an influence on the labor force. While the variables of domestic investment in the primary sector (X_1), foreign investment in the primary sector (X_2), and domestic investment in the tertiary sector (X_5) have a prob value. > 0.05 , meaning that these variables have no influence on the labor force.

5 Discussion

5.1 Effect of Domestic Investment in Primary, Secondary and Tertiary Sectors on Economic Growth

The results of data analysis and hypothesis testing that have been carried out in this study are shown in Table 1. shown in table 1, that the tertiary sector variable of domestic investment (X_5) is a sector that has no effect on economic growth when compared to the other two sector variables, namely the domestic investment sector (X_5). effect on economic growth when compared to the other two sector variables, namely the primary sector and the secondary sector, this is indicated by a significant value greater than α . This is indicated by a significant value that is greater than $\alpha 0.05$. This means that domestic investment in the tertiary sector, which is divided into eleven sectors, cannot affect economic growth in Indonesia. This happens because of uneven demand. Tertiary sector often depends on domestic demand. If people's purchasing power is low, demand for services (such as banking, education, and entertainment) is also limited, which means investment in the tertiary sector is unlikely to provide a significant economic boost.

Tertiary sector domestic investment variable (X_5) is a sector that has no effect on economic growth when compared to the other two sector variables, namely the primary sector and the tertiary sector, this is indicated by a significant value greater than $\alpha 0.05$. thus indicating that Indonesia's economic growth is not determined by tertiary sector domestic investment, meaning that domestic investment in the tertiary sector which is divided into eleven sectors cannot affect economic growth in Indonesia. This happens because of uneven demand. Tertiary sector growth often depends on domestic demand. If people's purchasing power is low, demand for services (such as banking, education, and entertainment) is also limited, meaning investment in the tertiary sector is unlikely to provide a significant economic boost.

Primary (X_1) and secondary (X_3) sectors are in accordance with what is stated by the Endogenous growth theory emphasizes the importance of innovation, improving the quality of human resources, and capital accumulation in driving long-

term economic growth. However, the tertiary sector (X_5) is not in accordance with the theory put forward. Investment in the tertiary sector is often more related to efficiency improvements and services that support other sectors (such as the primary and secondary sectors). However, if innovation or capital accumulation in the tertiary sector is limited or poorly directed, then its impact on economic growth can be insignificant. This means that the tertiary sector, although growing, does not directly create output that triggers economic growth like the secondary sector which has higher productivity. The above findings are in line with [11][14] that domestic investment is not significant to economic growth.

5.2 Effect of Foreign Investment in Primary, Secondary and Tertiary Sectors on Economic Growth

The results of hypothesis testing shown in table 1 that foreign investment in the primary (X_2), secondary (X_4) and tertiary (X_6) sectors has a significant effect on economic growth. This is indicated by a significant value that is smaller than $\alpha 0.05$. thus indicating that Indonesia's economic growth is largely determined by foreign investment in the primary, secondary and tertiary sectors. meaning that foreign investment in the primary, secondary and tertiary sectors, which are divided into seventeen sectors, can affect economic growth in Indonesia.

Primary sector (X_2) (agriculture, fisheries and mining), the increase in productivity of foreign investment brings new technology and management practices that can increase productivity in sectors such as agriculture and mining. In addition, there is a source of foreign exchange as commodities from the primary sector are often exported, generating foreign exchange that can strengthen the country's reserves and support macroeconomic stability.

Secondary sector (X_4) (manufacturing and industry), technology transfer means that foreign investment in the industrial sector is often accompanied by technology and knowledge transfer. This can improve domestic production capabilities and the quality of goods produced. In addition, with the development of the industrial sector, countries can diversify their economies and reduce dependence on the primary sector. This makes the economy more stable and resilient to commodity price fluctuations and can increase added value through raw materials from the primary sector can be processed domestically through investment in the manufacturing sector, thus creating greater added value and increasing national income.

Tertiary sector (X_6) (services and infrastructure) the improvement of infrastructure, namely foreign investment in the infrastructure sector (transportation, communication, energy) improves connectivity and facilitates the flow of goods and services, thereby promoting economic efficiency. Furthermore, the development of service sectors such as banking, information technology, and tourism, plays an important role in the modern economy. Foreign investment helps in the development of these sectors, which contributes to GDP growth as well as fosters innovation especially in information technology, fintech, and communications. This not only increases efficiency in other sectors, but also creates new industries.

This research is in accordance with what many economists including Keynes (Jhingan, 2003), Mankiw (2006), Harrod Domar (Arsyad, 2010), Solow-Swan (Arsyad, 2010), Kuznet (Arsyad, 2010), Todaro (2000), and Schumpeter (Sukirno,

2008) have stated theoretically that investment and economic growth rates affect each other and are significant.

The findings above are in line with research conducted by [16][5][8][20] which explains that foreign investment significantly affects economic growth.

5.3 Effect of Domestic Investment in Primary, Secondary and Tertiary Sectors on Labor Force

The results of the analysis and hypothesis testing in table 2 that domestic investment in the secondary sector variable (X_3) is a sector that affects the labor force when compared to the other two sector variables, namely the primary sector (X_1) and the tertiary sector (X_5). This is indicated by a significant value that is smaller than α 0.05. thus indicating that Indonesia's labor force is determined by domestic investment in the secondary sector. meaning that domestic investment in the secondary sector which is divided into seventeen sectors can affect the labor force in Indonesia. This happens because the secondary sector (X_3), especially the manufacturing industry, is one of the largest labor absorbers. The construction of factories, production facilities, and construction projects requires a lot of labor, ranging from skilled to unskilled workers. In addition, domestic investment in this sector can also encourage innovation and technological development, which in turn strengthens the competitiveness of local labor in the global market.

This research is in line with what is proposed by the Solow-Swan Model Theory. This model also shows how investment in physical capital, including in the manufacturing sector, can increase labor productivity. Increased productivity in the long run, results in more quality employment, especially when investment is combined with labor training and education.

The findings above are similar to those of [6][15] that the secondary sector has a significant effect on labor force absorption.

5.4 The Effect of Foreign Investment in the Primary, Secondary and Tertiary Sectors on the Labor Force

The results of data analysis and hypothesis testing that have been carried out in this study are shown in table 2 that foreign investment in secondary (X_4) and tertiary (X_6) sector variables have an influence on the labor force. This is indicated by a significant value that is smaller than α 0.05. thus indicating that the labor force in Indonesia is largely determined by foreign investment in the secondary and tertiary sectors. meaning that foreign investment in these two sectors which are divided into fifteen sectors can affect the labor force in Indonesia. The importance of modernization and productivity improvement in these two sectors. In the secondary sector (X_4), foreign investment brings more efficient production practices and technologies, which not only increases productivity but also expands industrial capacity. This leads to the need for more and skilled labor. The tertiary sector (X_6), particularly in the field of information and communication technology, requires workers with specific skills, which are usually met through training or education programs facilitated by foreign investment.

Foreign investment in the secondary and tertiary sectors has the potential to absorb large amounts of labor, especially in the more labor-intensive secondary sector. The tertiary sector, while not necessarily labor-intensive, contributes to quality job creation and supports the development of more advanced skills, particularly in the areas of financial services, education, and technology. Empirical research in several countries shows that foreign investment in these sectors can contribute to unemployment reduction, income generation, as well as skill development of the labor force.

The findings above are in line with research that foreign investment significantly impacts employment.

6 Conclusion

The conclusion of this study is that domestic investment in the primary and secondary sectors has a significant effect on economic growth while foreign investment in both the primary, secondary and tertiary sectors has a significant effect on economic growth. Furthermore, domestic investment in the secondary sector has a significant effect on the labor force while foreign investment in the secondary and tertiary sectors has a significant effect on the labor force.

Based on the results in this study, researchers put forward suggestions, the need for the government to pay full attention to domestic investment because increased investment in the country has a very broad and positive impact on the Indonesian economy, through multiplier effects in all sectors. The increase in the Indonesian economy is strongly influenced by foreign investment when compared to domestic investment, and therefore the state needs to take several strategic steps to encourage the growth of domestic investment while maintaining a healthy flow of foreign investment and Indonesia has a good investment climate in the primary, secondary and tertiary sectors will provide a stimulus to economic growth and labor force absorption. For future researchers, who will examine investment on economic growth and the labor force, it is advisable to examine in a long research period because economic growth and the labor force are macroeconomic problems in the long term. And can add other variables outside of this study.

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