



The Effect of Minimum Wage, Domestic Investment and Output Value on Labor Absorption in Java Island

Dian Isnaeni*, Harya Kuncara Wiralaga², Karuniana Dianta Arfiando Sebayang³
State University of Jakarta

Corresponding Author: Dian Isnaeni

Dianisnaeni_1701620106@mhs.unj.ac.id

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ABSTRACT

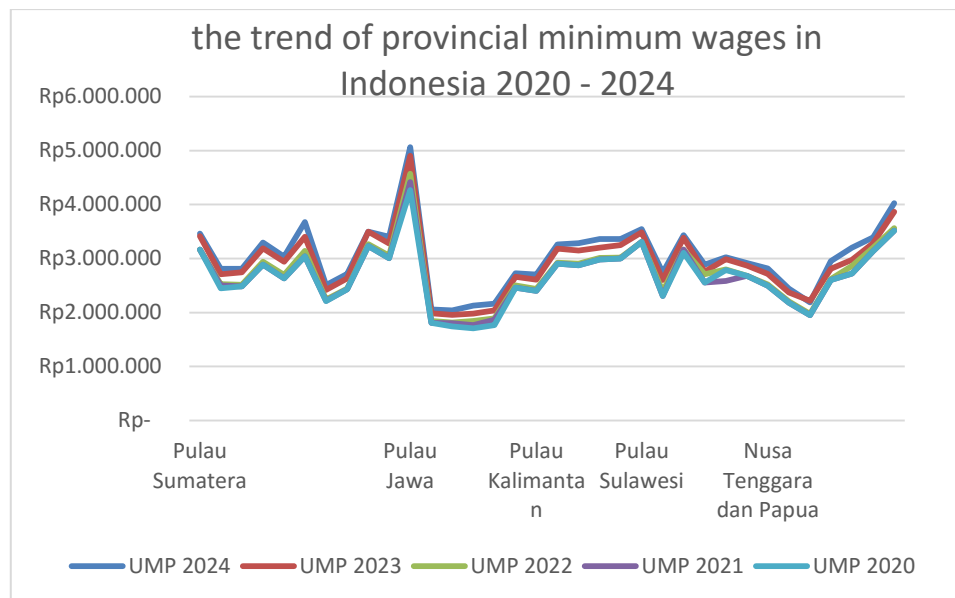
This study aims to determine the effect of minimum wages, domestic investment, and production output value on Java Island. The data used comes from the Central Statistics Agency in 2011-2022. The data was analyzed using panel data multiple regression with the Fixed Effect Model. The results of the study indicate that simultaneously minimum wages, domestic investment and output value have an effect on labor absorption. However, in terms of percentage, the minimum wage does not have a significant effect on labor absorption, while domestic investment and output value have a positive and significant effect on labor absorption.

INTRODUCTION

Population is a source of labor needed in development, although it plays a passive role in economic development. The planned development efforts begin with a process to improve which focuses on strengthening and advancing the economy in aspects of life. (Adawi & Azhari, 2022). Sukirno (2006) in Fatihudin (2019:7) argues that economic development is economic growth accompanied by transformation. The increase in population results in the expansion of the domestic market. This phenomenon has both beneficial and detrimental consequences for economic development efforts.

According to the 2020 population census data, 151 million people or more than 56.10% of the total population of Indonesia live on the island of Java. Although this figure has decreased from previous years, half of Indonesia's population still lives on the island of Java.

Based on the data below, the trend of provincial minimum wages on the island of Java is still relatively low when compared to other islands in Indonesia, although there are several areas with the highest minimum wages



Gambar 1. 1 The Tren of Provincial Minimum Wages in Indonesia 2020 - 2024

Sumber: Badan Pusat Statistik (data diolah)

The availability of jobs or demand for labor is influenced by the provision of salaries to workers. According to the theory put forward by Sudarsono, the demand for labor fluctuates in response to changes in wages and various other factors. Production costs are directly influenced by wage levels. When wages increase, employers tend to reduce their workforce to minimize costs.

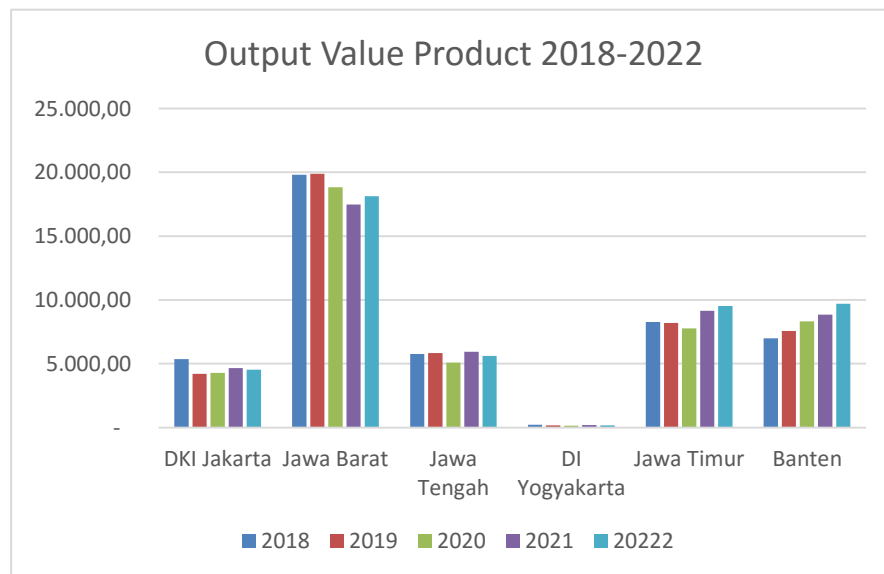
The next factor is domestic investment. Investment plays a role in economic growth and development. Investment is an economic activity to increase production capacity which causes the rate of economic growth to be followed by growth in employment opportunities (Hidayat, 2017).

Provincial	DI	FDI
Dki Jakarta	89,2	53,7
Jawa Barat	80,8	93,8
Jawa Tengah	25,0	33,9
Di Yogyakarta	2,3	1,6
Jawa Timur	65,4	45,0
Banten	31,3	48,9

Total Investment in 2022 (in billion rupiah)

Sumber : Ministry of Investment (Data processed)

According to the Ministry of Investment's 2022 report, West Java led investment realization with Rp174.6 trillion, followed by DKI Jakarta with Rp143.0 trillion. While other provinces on Java Island like Jakarta, Yogyakarta, and East Java primarily attracted domestic investments, they also drew significant foreign investment interest.



When production output increases, new job opportunities emerge. Output value represents the goods and services created through production processes. Higher output leads to increased industrialization. As industries generate more output and profits, they're motivated to expand their operations. Looking at the data from 2018-2022, output values fluctuated, with West Java consistently maintaining the highest output among all provinces. This demonstrates that greater production activity results in higher output, enabling business expansion.

Based on the discussed phenomena, this study aims to examine "The Impact of Provincial Minimum Wage, Domestic Investment, and Production Output Value on Labor Absorption in Java's Industrial Sector from 2012-2022.

LITERATURE REVIEW

Demand and Supply Labor

Lipsey's 1997 theory suggests that higher wages actually lead to increased job opportunities, helping reduce unemployment rates. This relationship between rising wages and increased employment was later supported by Papilaya & Sinay's 2022 research.

The concept of labor demand is unique because it's what economists call a "derived demand" (Kuncoro, 2002). This means companies don't hire workers just to have employees – they hire based on how many products consumers want to buy. Sukarniati (2019) builds on this idea, explaining that when customers want more products, businesses naturally need more workers and equipment to produce these goods and services.

The available workforce is directly linked to population size. However, Langoday (2024) emphasizes that people's education and skills are also key factors in determining their job prospects.

Labor Absorption

Labor absorption refers to the number of workers who are employed from the available workforce. It indicates the number of filled job positions, which is reflected in the number of employed residents. Employed individuals are distributed across various economic sectors. This distribution occurs due to the labor demand from these sectors. In other words, labor absorption is a manifestation of labor demand that exists across different sectors of the economy (Prihatini et al, 2020)..

Upah Minimum

Wages are mandatory payments that employers must provide to workers or laborers based on performed work. According to Adam Smith's classical theory, full employment occurs because wages function as a balancing mechanism between labor supply and demand, meaning wages are flexible. Smith argued that voluntary unemployment occurs when individuals are unwilling to accept the prevailing wage rates.

If all individuals accept the established wage rates, unemployment would not exist (Seran, 2023). The minimum wage is defined as a monthly standard minimum compensation from employers to workers for completed work, expressed in monetary terms (Putra et al., 2022). In essence, wages are compensation paid based on working days, hours worked, or the quantity of products produced by workers.

The Provincial Minimum Wage is a minimum salary standard established by provincial governments to ensure workers receive sufficient income to meet their most basic living needs. This standard applies throughout all districts/cities within a province.

H1: Minimum Wage has a negative and significant influence on Labor Absorption

Domestic Investment

The economic theory proposed by Harrod Domar explains that increased investment in a region can drive economic growth and raise per capita income

through the creation of productive activities. Investment can reduce income inequality when investment levels in an area increase, as this leads to the creation of new job opportunities. According to Salim and Sutrisno (2008), domestic investment refers to the participation of all Indonesian citizens who have capital to invest in various business sectors and technology development, thereby supporting both government initiatives and national development. This involvement of local investors helps strengthen the country's economic foundation through various business ventures and technological advancements.

H2: Domestic Investment has a positive and significant influence on Labor Absorption

Value Output Production

In Neo-Classical theory, Solow states that the combination of labor and capital in production determines the amount of output generated. Therefore, economic growth is determined by the availability of production factors such as population, labor, capital accumulation, and technological advancement (Seran, 2023).

Output refers to various beneficial products and services created through production processes. These products and services serve two main purposes: they can either be consumed directly or used as inputs in subsequent production processes. An increase in industrial output enhances productivity, which aims to address various challenges in improving and maintaining a company's market competitiveness (Kodrat, 2022).

H3: Value Output Production has a positive and significant influence on Labor Absorption

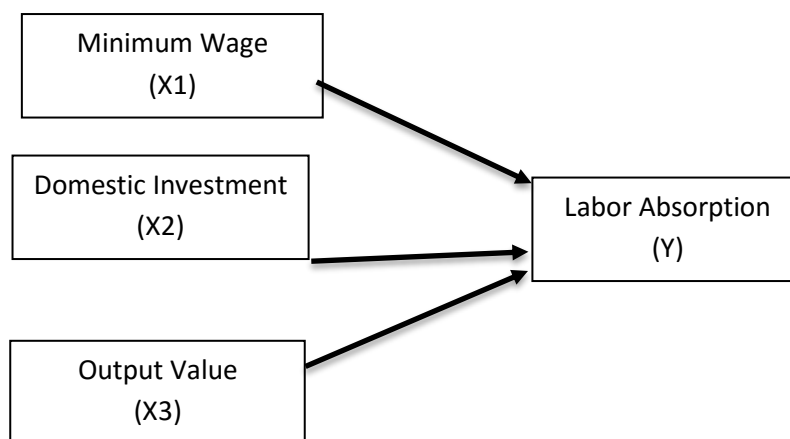


Figure 1. Conceptual Framework

METHODOLOGY

This research uses labor absorption as the dependent variable, measured by the number of currently employed workers (in millions). The independent variables are Minimum Wage, Domestic Investment, and Output Value. The study employs panel data combining cross-sectional data from six provinces in

Java and time series data over 11 years (2012-2022). All data was sourced from the Central Statistics Agency.

The data analysis technique uses multiple regression for panel data through E-views software. There are three estimation models available for panel data regression: Common Effect, Fixed Effect, and Random Effect. To determine the best model, selection tests will be conducted using the Chow Test, Hausman Test, and Lagrange Multiplier Test. Additionally, t-tests and f-tests will be performed to examine both the partial and simultaneous effects of independent variables on the dependent variable.

The multiple regression model for panel data used in this research is as follows:

$$Y_{it} = \alpha + \beta_1 MW_{it} + \beta_2 DI_{it} + \beta_3 OUTPUT_{it} + \varepsilon_{it}$$

Information:

- Y : Labor Absorption
- X1 : Minimum Wage
- X2 : Domestic Investment
- X3 : Value Output
- α : Constant
- $\beta_1 \beta_2$: Regression Coefficient
- ε : Error Standards

RESEARCH RESULT

The determination of the best model in this research involves several tests: the Chow Test, Hausman Test, and Lagrange Multiplier Test. The test results can be illustrated in the following table

Table 1. (Estimation Model Determination)

Method	Probability	Information
Chow Test	0.0000	FEM
Hausman Test	0.0009	FEM
LM Test	-	-

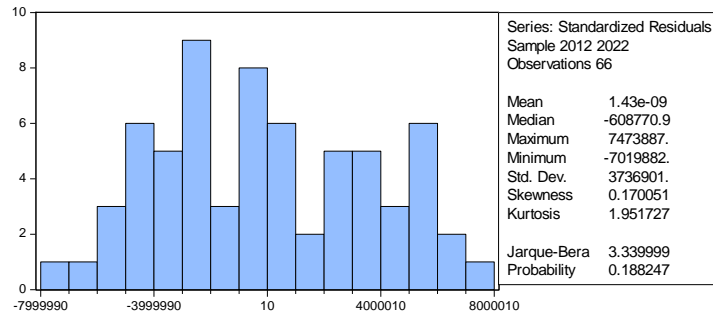
The determination of the most appropriate panel data regression model was conducted through a series of statistical tests. First, the Chow test showed probability values for both cross-section F-statistic and Chi-square of 0.0000, which is less than the significance level of 0.05. This result indicates that the Fixed Effect Model (FEM) is more appropriate to use compared to the Common Effect Model.

Furthermore, the Hausman test yielded a cross-section random probability value of 0.0009, which is also below the significance level of 0.05. This finding further reinforces that the Fixed Effect Model is the most suitable choice compared to the Random Effect Model.

Classic Assumption Test

Normality Test

Normality test is a procedure that aims to determine whether the measured data is normally distributed or there is no residual data. Normal distribution occurs when the mode, mean, median are in the middle.



Picture 2. Normality Test

Based on the results of the normality test, the Jarque-Bera probability is $0.188247 > 0.05$ so that the data is normally distributed.

Multicollinearity Test

Multicollinearity test is a procedure that aims to test the correlation between independent variables. A good regression model should not have a perfect correlation between independent variables. The results of the multicollinearity test use VIF (Variance Inflation Factor).

Table 2. Multicollinearity Test

Variabel	Coefficient Variance	Uncentered VIF	Centered VIF
C	1.40E+12	6.307671	NA
MW	0.429768	7.613669	1.555300
DI	1309.691	6.620107	2.573243
OUTPUT	17470.62	4.609289	1.921698

Based on the results of the multicollinearity test conducted by the researcher, the VIF value for Minimum Wage is $1.555300 < 10$; Domestic Investment is $2.573243 < 10$; Output is $1.921698 < 10$ so it is free from multicollinearity symptoms.

Heteroscedasticity Test

The Heteroscedasticity test is conducted to analyze whether the regression model contains errors in data with equal or unequal variance.

Table 3. Heteroscedasticity Test

Variable	Coefficient	Std. Error	t-Statistic
C	2754834.	828932.3	3.323352
UMP	0.502024	0.648713	0.773878
PMDN	-11.99470	25.69114	-0.466881

OUTPUT	-24.11826	120.4433	-0.200246
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Based on the Glejser Test results conducted by the researcher, the significance levels for each variable were 0.4422, 0.6424, and 0.8420, all of which are greater than 0.05. Therefore, it can be concluded that this research is free from heteroscedasticity.

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The panel data regression equation aims to estimate the impact on the dependent variable when independent variables are increased or decreased. The following presents the panel data regression results using the Fixed Effect Model (FEM).

Table 4. Hypothesis Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	10219018	215754.0	47.36422	0.0000
MW	-0.303091	0.168846	-1.795069	0.0779
DI	16.64958	6.686874	2.489890	0.0157
OUTPUT	253.5083	31.34890	8.086672	0.0000
R-squared	0.997050			
Adjusted R-squared	0.996636			
F-statistic	2408.399			
Prob(F-statistic)	0.000000			

Simultaneous Test (F-Test)

The F-test or simultaneous test is used to examine the combined or simultaneous effect of independent variables on the dependent variable. The F-calculated value of 2408.399 is greater than the F-table value of 2.523, indicating that the minimum wage, domestic investment, and output value variables simultaneously have a significant influence on labor absorption in Java.

This research has an R Square value of 0.997050, which means that the independent variables can explain 99.70% of the variation in the dependent variable, while the remaining 0.3% is influenced by other factors not discussed in this study. This high R Square value suggests that the model has a very strong explanatory power in predicting labor absorption patterns in Java.

Partial Test (T-Test)

The t-test or partial test is a hypothesis test used to examine the influence of each independent variable on the dependent variable. For the minimum wage variable (X1), the t-calculated value was 1.795069, which is less than the t-table value of 1.9966. Therefore, H0 is accepted and H1 is rejected, indicating that there is no significant influence of minimum wage on labor absorption, meaning changes in minimum wage do not affect existing employment opportunities. For the domestic investment variable (X2), the t-calculated value

was 2.489890, which is greater than the t-table value of 1.6683. Thus, H_0 is rejected and H_1 is accepted, showing a significant influence of domestic investment on labor absorption, meaning increases in domestic investment affect available employment opportunities. Finally, for the output variable (X_3), the t-calculated value was 8.086672, which is greater than the t-table value of 1.6683. Therefore, H_0 is rejected and H_1 is accepted, demonstrating a significant influence of output on labor absorption, indicating that increases in production quantity will lead to increases in employed workforce.

DISCUSSION

This research demonstrates that the Minimum Wage does not have a significant impact on labor absorption, primarily because higher minimum wage requirements can lead to reduced employment opportunities. When wages are mandated to increase, businesses face higher operational costs. To manage these increased costs, employers often respond by hiring fewer workers or reducing their workforce (Widyapangesti et al., 2022). Additionally, the insignificant wage effect can be attributed to the fact that wage increases can lead to decreased demand for labor quantity. This means that if wages rise while other input prices remain constant, labor becomes relatively more expensive. Consequently, companies tend to choose cheaper alternatives to labor input to maintain their profitability (Kuncoro, 2002).

Furthermore, the neoclassical theory of the law of diminishing returns typically applies to the Marginal Product of Labor (MPL). Initially, when labor is added while capital remains constant, production output increases. However, after reaching a certain point, additional workers actually cause a decrease in production output. A business unit will compare the additional revenue generated by each worker, known as the Marginal Revenue Productivity of Labor (MRPL), with the wage cost (w) that must be paid for that labor. To maximize profits, entrepreneurs will continue to recruit new workers as long as the Marginal Revenue Productivity of Labor (MRPL) exceeds the wage rate (w), or until the point where MRPL equals w . If MRPL falls below w , a business unit can increase its profits by reducing its workforce (Busra et al., 2020).

This theory is supported by data from the Central Statistics Agency in 2022, which shows the percentage of formal workforce across provinces: DKI Jakarta at 63.12%, West Java at 45.39%, Central Java at 39.84%, DI Yogyakarta at 46.62%, East Java at 36.14%, and Banten Province at 52.04%. This data reveals that five out of six provinces in Java (West Java, Central Java, DI Yogyakarta, East Java, and Banten) have more than 50% of their workforce in the informal sector. This indicates that the minimum wage set by the government only applies to a portion of workers in the formal sector.

The next variable, domestic investment as measured through realized domestic investment, shows a significant and positive impact on labor absorption in Java. This is reinforced by economist Harrod Domar, who explains that increased investment in a region can drive economic growth and per capita income through the creation of productive activities. Investment plays a dual role in the economy by affecting both demand and supply. On the

demand side, investment generates income and stimulates economic activity. On the supply side, investment increases the economy's production capacity by expanding available capital stock. This means when businesses invest in new equipment, facilities, or resources, it not only creates immediate economic activity but also builds long-term production potential (Rumawir, 2019).

This research aligns with studies by Marsudiarso et al. (2022), Ferina & Anis (2020), Dewi & Gunawan (2018), and Atuma et al. (2017), which found that Domestic Investment has a positive and significant impact on labor absorption. This condition assumes that investment is a driving factor for business sustainability and plays a crucial role in creating job opportunities. When businesses receive investment, they can expand production, leading to increased recruitment and job creation.

The next variable, Output Value, also shows significant and positive results for labor absorption. Consumer demand directly influences employment levels. When consumers purchase more products, companies must increase their production to meet this higher demand. This is because if production output value increases, it will enhance production capacity, thereby expanding job opportunities.

This production expansion creates a need for additional workers, prompting companies to hire more employees to handle the increased workload. The expansion of production output value creates a cascading effect on employment, particularly in the industrial sector (Krissawindaruarta et al., 2019). This aligns with research conducted by Zahra et al. (2022), Soca & Woyanti (2021), and Gulo et al. (2022), concluding that Production Output Value has a positive and significant effect on labor absorption. Neoclassical growth theory considers that output is a function of input factor growth, particularly capital and labor, as well as technological advancement. This contributes to the increase in job opportunities (Papilaya, 2024).

CONCLUSIONS AND RECOMMENDATIONS

Based on the research conducted regarding the impact of minimum wage, domestic investment, and production output in Java during the 2012-2022 period, it can be concluded that minimum wage does not have a significant effect on labor absorption. However, it cannot be concluded that all workers do not receive wages according to the established minimum standards. This is because wages in the informal sector are often determined through negotiations between workers and employers, with no officially set minimum wage.

Furthermore, domestic investment shows a positive and significant impact on labor absorption. These results align with the previously mentioned theories, demonstrating that investment capital flow directly affects companies' ability to maintain and develop their workforce. The presence of domestic investment creates job opportunities for people who need or seek employment. The next variable, Production Output Value, shows a positive and significant effect on labor absorption in this research. This is because an increase in production output value leads to enhanced production capacity, thereby expanding job opportunities.

The findings of this research are expected to serve as considerations for the government and relevant institutions in their efforts to expand employment opportunities for society. Moreover, if consumer demand remains strong over time, these employment effects become more permanent. Companies invest in long-term workforce development through training programs, and job security increases. This sustainable growth can result in competitive wage increases as companies strive to attract and retain qualified workers. The result is a stronger local economy with stable employment opportunities and improved living standards for society

ADVANCED RESEARCH

This research has several limitations. Firstly, the study only covers six provinces out of thirty-eight provinces in Indonesia, with a timespan of 11 years, which means it may not fully represent the overall labor absorption conditions across Indonesia.

Additionally, there is a limited availability of research references regarding the individual effects of minimum wage, domestic investment, and production output value in Java. Therefore, future researchers are encouraged to expand the scope to both national and international levels, as well as extend the research timeframe. This expansion would allow for more representative research findings across all aspects.

The suggestion for future studies emphasizes the need for broader geographical coverage and longer time periods to provide a more comprehensive understanding of labor absorption dynamics. This would help create research that is more representative and thorough in its analysis of all relevant aspects.

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