



## THE EFFECT OF MICRO, SMALL AND MEDIUM ENTERPRISES, CAPITAL EXPENDITURE, INVESTMENT, AND LABOR ON INDONESIA'S ECONOMIC GROWTH

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### Abstract

*This study aims to analyse the effect of micro, small, and medium enterprises (MSMEs), capital expenditure, investment, and labour on Indonesia's economic growth. This research adopts a quantitative methodology and bases its findings on secondary data obtained from the Central Statistics Agency. The analysis included 330 samples from 33 provinces, all chosen using the purposive sampling method. The total number of observations in the study was 33. According to the panel data analysis, findings carry out with the aid of the programme processing tools found in E-Views 9.0. The results of this study show that capital expenditure, investment, and labour partially have a significant positive effect on Indonesian economic growth. On the other hand, variable MSMEs have no impact on the economic development of Indonesia. Another finding from the analysis is that the estimated regression model can explain Indonesia's economic growth.*

**Keywords:** *Micro, small and medium enterprises; capital expenditures; investment; labour; economic growth.*

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### INTRODUCTION

The rate of economic expansion frequently uses as a proxy for a nation's standard of living. A high GDP growth rate indicates that the country has been prosperous in its efforts to modernise its economy and raise the living standards of its citizens. The value of goods and services produced during a given time is a proxy for economic growth (Amri, 2017). Then the higher the economic development of a country, the higher the economic activity that occurs in that country. Economists use various data types to measure economic growth, like Gross Domestic Product (GDP), inflation rate, and unemployment rate (Mankiw, 2019). GDP is often considered the most appropriate measuring tool to measure an economy's performance. It indicates a country's total income and total expenditure on its output of goods and services. As for the regional level, the indicator used is the Gross Regional Domestic Product (GRDP).

The global economy in 2019 experienced a slowdown due to various countries' financial, political, and trade issues. According to the United Nations (2020), global economic growth in 2019, which only reached 2.3 per cent, was the lowest in the last decade. Causative factors for this slowdown, among other things, are the USA versus China trade war, the 'Brexit' issue, geopolitical tensions in some countries, e.g. USA versus Iran, falling commodity prices, and the slowdown in many countries' domestic economies. In 2020, the global economy was also facing challenges from the Coronavirus Disease (Covid-19) pandemic, which has paralysed most activities and the economy.

In the current global economic crisis, the difference is the speed and depth of a country in carrying out economic recovery (Soleha, 2020). Micro, small, and medium enterprises (MSMEs) are one of the main drivers of socioeconomic development in a country or region because their presence can permanently create new jobs (Razumovskaia et al., 2020). According to Indonesian Law Number 20 of 2008 (MSMEs Law), MSMEs are productive economic businesses owned by individuals and business that is not part of a company or business that is not owned and controlled by other large corporations. The MSMEs meet the requirements of micro, small, or medium enterprises as stipulated in the law. According to Tambunan (2020), MSMEs survived the Asian economic crisis in 1997-1998 and the global financial crisis in 2008-2009. One of the empirical pieces of evidence is the increase in the number of MSMEs in 1998 and 1999 after the problem, which continued to grow during the 2008-2009 crisis. A study by Yoshino and Taghizadeh-History (2018) shows that in Asian countries, MSMEs play a significant role, especially as job creators and exporters of production to foreign countries. Data from the Ministry of Cooperatives and SMEs (2019) shows that compared to large businesses, in MSMEs, there are up to 99 per cent job opportunities, absorb 97 per cent of the total workforce, contribute 61.07 per cent of the actual national GDP, 14.37 per cent of total exports, and 60.42 per cent of total investment. This data shows how significant Msme's contribution is to the Indonesian economy.

Sarah, Atmaja, and Verawati (2019) stated that MSMEs have advantages because they are engaged in the labour-intensive sector and can utilise natural resources. The benefits of micro and small businesses are mainly in the agricultural industry of food crops, plantations, livestock, fisheries, trade, and restaurant services. Medium enterprises excel in creating added value in the hospitality, financial, leasing, corporate, and forestry services sectors. Meanwhile, large businesses excel in the processing, electricity, gas, communications, and mining industries. MSMEs and large businesses are complementary, but MSMEs have proven to be more dominant in absorbing labour and influencing total income. In competition with large companies, MSMEs excel because they have the flexibility and a concise bureaucracy to react more quickly to the challenges of business competition (Putri, 2019). A study by Nursini (2020) concluded that MSMEs are engines of economic growth, where there is a positive correlation between MSME growth and economic improvement. However, other studies by Ridlo and Setyani (2018) and Halim (2020) stated that the development of MSMEs does not affect economic growth.

## **LITERATURE REVIEW**

The availability of economic resources needs natural resources, human resources, and productive capital (Gusmawardhani, 2018). Productive capital can source from government expenditure, which is essential in financing development activities (Zahari, 2017). Government capital expenditure intended for asset acquisition and adding value to fixed or other assets can provide more benefits in one accounting period, such as land, machinery, vehicles, buildings, roads, bridges, and irrigation. During

the economic crisis due to the pandemic, the increase in government expenditure will boost consumption and investment, thereby increasing national income and decreasing the unemployment rate. Jhingan (2016) argues that political factors help modern economic growth, and government behaviour is essential in encouraging or hindering economic activity. Many studies have found that government expenditure positively affects economic growth, meaning that real GDP will also increase when there is an increase in spending. This result support Pangiuk (2017) and Ichvani and Sasana (2019) but differs from the studies by Safari and Fikri (2016) and Radulescu, Serbanescu, and Sisini (2019), which found that government expenditure harms economic growth.

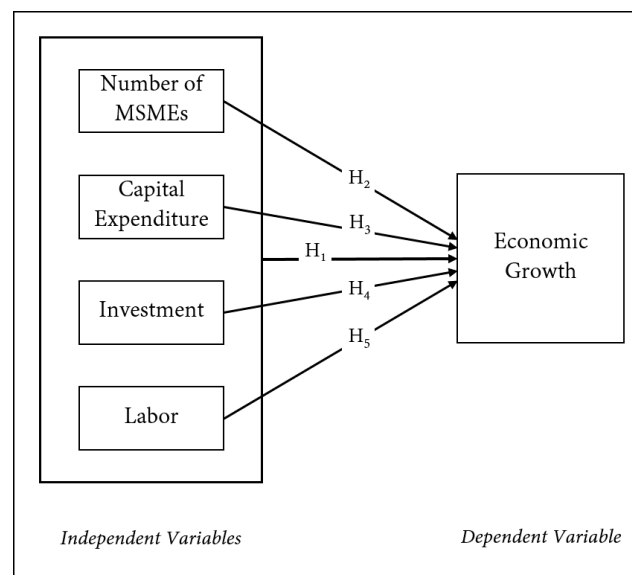
Sources of productive capital for economic development can also derive from the private sector or private investment. Investment is spending on goods that will use to get more services and goods (Mankiw, 2019). According to Todaro and Smith (2020), investment is essential in driving the country's economic life because capital formation can increase production capacity and national income and create new jobs that can expand employment opportunities. Private investment can be sourced from within the country (Domestic Investment/PMDN) and outside the country (Foreign Investment/PMA). The Law of the Republic of Indonesia Number 25 of 2007 (Investment Law) regulates investment policies that must always side with the welfare of the community, which impacts the development of MSMEs and cooperatives. Increased investment is also needed to cultivate the economic potential in the context of realising economic and political sovereignty and supporting Indonesia's economic development.

Keynes in Benigno & Fornaro (2018) states that the level of economic growth has a positive correlation with investment. It means that the higher the economic growth, the higher the investment inflow. Investment creates new jobs to reduce unemployment, increase people's income, and enable technology and knowledge transfer, especially in developing countries. This theory supports the results of research by Sari, Syechalad, and Majid (2016) and Koyongian, Kindangen, and Kawung (2019), which stated that investment positively affects economic growth. However, it contradicts Ulfa and Zulham (2017) and Safrianto (2018), who found that acquisition did not affect economic growth.

Human resources are the following economic resources besides natural resources and productive capital (Gusmawardhani, 2018). Human resources or labour are necessary capital in regional economic development, financed through government expenditure and investment, aside from physical money. Labour grow traditionally considered one of the positive impacts that spur the economy's growth. (Todaro & Smith, 2020). Indonesian Law Number 13 of 2003 (Manpower/Labor Law) mentions that in implementing national development, labour has a significant role and position as both actors and result goals. This law defines labour as everyone expects to be able to do work that produces goods and or services both to meet individual and community needs. Labour and unemployment are significant concerns in various countries, especially developing countries (Soleh, 2017). Unemployment arises due to the government's inability to take advantage of the excess available labour. Therefore, population

growth must balance employment growth so the labour force can optimally absorb. Studies conducted by Menajang (2019) and Puspasari (2019) found that labour positively influences economic growth. In contrast, Simionescu et al. (2017) stated that labour harms economic growth, while Gwijangge, Kawung, and Siwu (2018) and Lamazi (2020) found that there is no correlation between labour and economic development.

This study aims to see how the numbers of MSMEs, government capital expenditure, private investment, and labour numbers simultaneously and partially affect Indonesia's economic growth. Based on the research gap mentioned above, mixed results from research on economic growth using the variable of MSMEs, capital expenditure, investment, and labour. Also, there have yet to be studies that use a similar research model, with numbers of MSMEs, capital expenditure, investment, and labour as independent variables and economic growth as a dependent variable. Based on the explanation, the researchers provide a theoretical framework as in Figure 1.



**Figure 1. Theoretical Framework**

Source: Researcher (2021)

## METHOD

This study uses a quantitative approach in the form of associative to determine the influence of the independent variables on the dependent variables. In general, quantitative research, in its methods, involves the process of collecting, analysing, and interpreting data, as well as writing research results (Untung, 2019). More specifically, quantitative research methods relate to identifying samples and populations, determining research strategy, collecting and analysing data, presenting research results, and interpreting and writing research results (Creswell & Creswell, 2018). According to Sugiyono (2019), the quantitative approach is suitable for research on a large population where the problem is

clear, observable, and measurable, and the researcher intends to understand a complex, meaningful social situation deeply. At the same time, the associative method is a problem formulation method that inquires about the relationship between two or more variables that is symmetrical, causal, interactive or reciprocal (Sugiyono, 2019). Furthermore, the associative strategy uses to identify the extent of the influence of the exogenous variables on endogenous variables, either partially or simultaneously.

This study uses a non-probability and purposive sampling method. The criteria for sample choosing are that the province must have complete data on the Growth of Regional Domestic Product (GRDP), numbers of MSMEs, capital expenditure, investment, and labour for 2010-2019. The sample chosen is 33 provinces, excluding North Kalimantan, which form in 2014; thus, it has no data for 2010-2014.

The independent variables are micro, small and medium enterprises (MSMEs), capital expenditures, investment, and labour, while the dependent variable is economic growth. This study aims to obtain empirical evidence about the influence of Micro, Small and Medium Enterprises (MSMEs), capital expenditures, investment, and labour on Indonesia's economic growth. The data used is secondary data obtained from the website of the Central Statistics Agency (BPS), the Indonesian Investment Coordinating Board (BKPM), the Ministry of Cooperatives and SMEs, and the Bank of Indonesia.

The regression model used in this study is a data panel model, a combination of cross-section and time series data. The analysis tool used in this study is Eviews 9.0 program. The equation for the model is as follows:

$$Y = \beta_0 + \beta_1 UMKM + \beta_2 BM + \beta_3 INV + \beta_4 TK + \varepsilon$$

Description:

Y = Economic growth (using GRDP as the proxy)

UMKM= Numbers of micro, small and medium enterprises (MSMEs)

BM = value of capital expenditure

INV = value of an investment

TK = number of labour

$\beta_0$  = Constant

$\beta_{1-4}$  = Regression coefficient

$\varepsilon$  = Error standard

## RESULT AND DISCUSSION

Based on Table 1, the number of observations in the study was 330 samples. The MSME variable's maximum value of 1030374 was in Central Java in 2015, and the minimum value of 1194

was in West Papua in 2012. The average value of the MSME variable was 112047.8 with a standard deviation of 192650,9.

**Table 1: Descriptive Statistics**

	<b>SEMES</b>	<b>BM</b>	<b>INV</b>	<b>TK</b>	<b>PDRB</b>
Mean	112047.8	1184.401	15676.67	3525216.	267972.6
Median	55078.50	759.2762	6902.163	1918984.	111761.0
Maximum	1030374.	14118.61	131036.0	22063833	1836198.
Minimum	1194.000	108.9970	23.36320	316547.0	14983.91
Std. Dev.	192650.9	1720.777	23339.21	4959911.	375933.8
Observations	330	330	330	330	330

Source: Output E-views 9.0 (Processed Data)

In the capital expenditure (BM) variable, the maximum value of 14118.61 is in DKI Jakarta in 2018, and the minimum value of 108.997 is in Gorontalo in 2010. The average value of the BM variable is 1184.401, with a standard deviation of 1720.777.

Furthermore, for the investment variable (INV), the maximum value of 131036 was in West Java in 2019, and the minimum value of 23.3632 was in DI Yogyakarta in 2011. The average value of the INV variable is 15676.67, with a standard deviation of 23339.21. The last independent variable, labour (TK), had a maximum weight of 22063833 in West Java in 2019 and a minimum value of 316547 in West Papua in 2010.

And the average value of the TK variable is 3525216, with a standard deviation of 4959911. As for the dependent variable GRDP, the maximum value of 1836198 own by DKI Jakarta in 2019, and the minimum value of 14983.91 was in North Maluku in 2010. Therefore, the average value of the variable is 267972.6 with a standard deviation of 375933.8.

The result of the estimation method selection test (Chow and Hausman test) concludes that the most appropriate model for regression testing is Fixed Effect Model (FEM). The regression result using FEM is as follows:

**Table 2: Regression Test**

<b>Variable</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
Constant	3.902107	0.884114	6.387815	0.0000
UMKM	0.020330	0.012053	1.686779	0.0927
BM	0.109938	0.012113	9.075929	0.0000

INV	0.022015	0.005840	3.769780	0.0002
TK	1.261327	0.084776	14.87829	0.0000
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R-squared	0.996765	F-statistic	2507.828	
Adjusted R-squared	0.996368	Prob(F-statistic)	0.000000	
		Durbin-Watson stat	0.920987	
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Source: output E-views 9, 2021 (Processed Data).

Based on the regression result, the probability value (F-statistic) is 0.0000, which is less than the significance level of 0.05. This result suggests that simultaneously the numbers of MSMEs, capital expenditure, investment, and labour can explain Indonesia's economic growth. The adjusted R-squared value of the regression is 0.9964. Therefore, it can interpret as the four variables' ability to explain economic growth is 99.64 per cent. In contrast, the other 0.36 per cent define by other variables that didn't use in this model.

The numbers of Micro, Small, and Medium Enterprises (MSMEs/UMKM) do not influence the economy's growth. The variable has a probability value level of 0,0927, which is more than the significance level of 0,05. It is because the number of MSMEs didn't evenly distribute throughout Indonesia. Data from BPS in Table x shows that 62.36 per cent of the total MSMEs are centred in Java Island, while only 1.41 per cent are in the Maluku-Papua region. With this condition, the critical role of MSMEs, namely creating jobs and increasing national output, is unevenly distributed throughout all the provinces. Another factor is the challenges faced by MSMEs owners, both financially and non-financially. Rohman (2019) mentioned that MSMEs are still experiencing many obstacles, such as problems in production, marketing, and capital, so their business activities cannot maximise economic growth. These results are in line with research by Ridlo and Setyani (2018) and Halim (2020), which state that MSMEs do not influence the growth of the economy.

Capital expenditure has a significant favourable influence on the growth of the economy. The variable has a probability value of 0.0000, less than the 0.05 significance level. The coefficient for this variable is 0.109938, indicating that for every 1 unit increase in capital expenditure, the economy's growth will grow by 0.109938 units (*ceteris paribus*). It is because the Indonesian government has effectively and efficiently used their budget to purchase or add capital goods that significantly boost economic activity in the community. For example, by building infrastructures such as roads and bridges, reservoirs/dams, and irrigation, as well as increasing access to clean water and sanitation. Capital expenditure is also allocated to meaningful and productive sectors such as education, health, and transportation so that it impacts people's welfare and creates a better Indonesian business climate that can attract more capital owners to invest in Indonesia. Therefore, increased capital expenditure will

affect growing community economic activity in various sectors to increase productivity, open up business fields, and reduce unemployment, which will impact economic growth. Studies by Pangiuk (2017) and Ichvani and Sasana (2019) also state that capital expenditure has a significant favourable influence.

Investments have a significant favourable influence on the growth of the economy. The variable has a probability value of 0.0002, which is less than the 0.05 significance level. Therefore, the coefficient for this variable is 0.022015, indicating that for every 1 unit increase in capital spending, the economic growth will grow by 0.022015 unit (*ceteris paribus*). During the research period from 2010-2019, domestic and foreign investments have been an effective source of funds for Indonesia's economic development. One example of using investment is as a co-fund for infrastructure development, which government capital expenditures cannot fully cover. In addition, a foreign investment that comes in the form of a new business entity establishment (e.g., factory, office), as stipulated in the Investment Law (UU Penanaman Modal), can create job opportunities, therefore able to absorb labour and reduce the unemployment rate. The result is the following research by Sari, Syechalad, and Majid (2016) and Simionescu et al. (2017), which conclude that investment significantly influences economic growth.

The last variable, labour, have a significant favourable influence on the growth of the economy. It has a probability value of 0.0000, which is less than the 0.05 significant level. The coefficient for this variable is 1.261327, indicating that for every 1 unit increase in capital expenditure, the economic growth will grow by 1.261327 units (*ceteris paribus*). It is due to the vital role of labour as a production factor. The increasing population will increase the available workforce. If accompanied by the availability of job opportunities, this workforce can optimally absorb into a force that effectively and efficiently increases production output. The absorption of an appropriate and targeted workforce can increase national income and positively impact economic growth. Results from this study are consistent with those of Menajang (2019) and Puspasari (2019), which find that increases in labour productivity significantly boost economic growth.

## **CONCLUSIONS AND SUGGESTIONS**

Partially capital expenditure, investment, and labour significantly positively affect economic growth. The government uses the capital expenditure budget efficiently and effectively to support economic activity, such as financing infrastructure development. The funding is also allocated effectively for the most priority, important, and productive sectors, such as health and education. Investment is an effective source of financing that can be a co-fund for government expenditure to build infrastructure. The Investment Law, which states that investments made by foreign investors in the form of the establishment of new business entities are also able to give positive multiplier effects for the economy's growth, was recently passed. Labour absorption in Indonesia has generally increased and is



followed by the creation of job opportunities due to the realisation of investment so that production results increase and the unemployment rate decreases, which in turn impacts economic growth.

The number of MSMEs does not affect economic growth due to the uneven business unit distribution throughout the 33 provinces and the many challenges that MSMEs practitioners face. Therefore, the vital role of MSMEs, which are creating jobs and increasing national output, could not happen evenly and simultaneously in Indonesia. Nevertheless, empowering MSMEs is essential to improving Indonesia's economic growth. Therefore, the government, both on a national level (Ministry of Cooperatives and SMEs) and regional level (Department of Industry, Trade, Cooperatives, and SMEs), can focus more on developing the potential of MSMEs, especially those located outside Java and Sumatra islands. It can do by providing workshops and intensive training that can increase the capacity, ability, competitiveness, and entrepreneurial spirit of MSMEs owners.

The limitation of this study is the limited range of research periods which only ranged from 2010 to 2019. The short period is due to the need for MSMEs data from official agencies and ministries, so this study cannot include the most recent economic situation. Henceforth, this study suggests that further research expand the study period up to 2020 to capture Indonesia's current state, especially to cover the case during the Covid-19 pandemic. Other research also suggests using another variable to indicate MSMEs, such as output, investment, or turnover, which has a better ability to reflect the performance of MSMEs. Another limitation is the difference in the data of MSMEs from BPS and the Ministry of Cooperatives and SMEs. The BPS data does not reflect the actual numbers of MSMEs because it only bases on a survey result done in 2016. The Ministry of Cooperatives and SMEs data only cover the national and not provincial/regional numbers. Therefore, this study suggests that the government could provide a more current and complete data source. The availability of comprehensive data will facilitate further research related to Indonesia's MSMEs.

This study also recommends that the government increase private investment in Indonesia by creating a better business climate, such as deregulating inefficient terms and regulations, simplifying administrative management, or providing incentives for capital owners.

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