

CHAPTER I

INTRODUCTION

1.1 Background

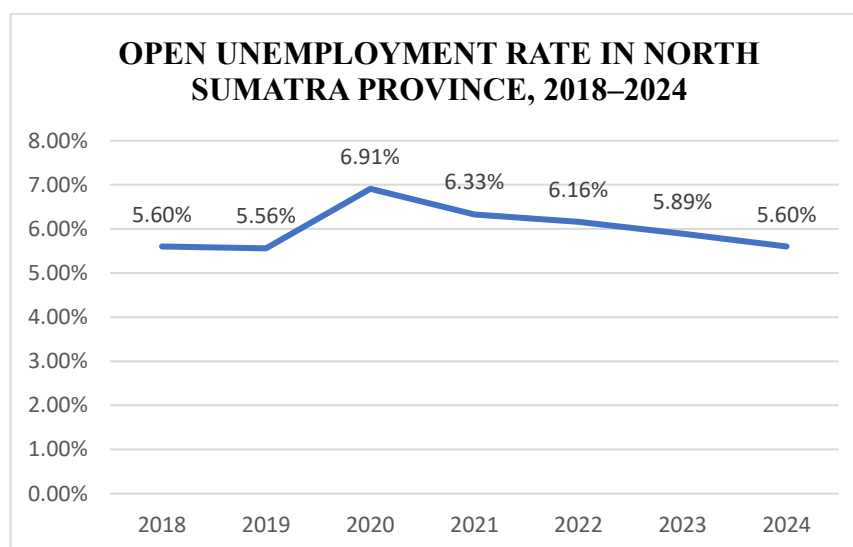
Development is a process aimed at achieving societal prosperity through economic growth. The primary objectives of economic development efforts, in addition to generating the highest possible growth, are to reduce income inequality and unemployment rates (Todaro & Smith, 2015) as cited in (Dewi, 2022) . Since economic growth is theoretically considered capable of increasing labor absorption, expanding employment opportunities, and lowering unemployment rates, economic growth is often regarded as the primary indicator of the success of public policy in the context of regional development. (Asmara et al., 2024)

Several studies indicate that when economic growth is driven by capital-intensive sectors, technological advancements, or concentrated in specific sectors, increased output does not automatically create new jobs. This situation results in persistently high unemployment rates despite economic growth, a phenomenon known as *jobless growth* or growth without job creation (Kumar, 2024) .

Given Indonesia's economic structure, which is dominated by the informal sector and sectors facing "*jobless growth*" issues, the problem of rising unemployment has become increasingly critical. The open unemployment rate (OUR) remained at 4.91%, even though national economic growth in 2024 reached approximately 5% (BPS, 2024). This indicates that the economic growth has not yet encompassed the labor market as a whole. Consequently, the benefits of growth have not been felt equally by all segments of society.

The economic and labor market dynamics of North Sumatra Province are highly complex within a regional context. According to the North Sumatra Provincial BPS (2024), the trade, manufacturing, and agriculture sectors demonstrated significant economic growth of 5.03% in 2024. However, the province's open unemployment rate remains higher than the national average, at approximately 5.60%. This situation indicates an imbalance between economic progress and the ability to create jobs.

Figure 1.1 Open Unemployment Rate in North Sumatra Province, 2018–2024



Source: North Sumatra Provincial Statistics Agency

Figure 1.1 shows the development of the Open Unemployment Rate (OUR) in North Sumatra Province, which has experienced fluctuating dynamics. At the beginning of the observation period, the open unemployment rate stood at around 5.60 percent in 2018 and declined slightly in 2019. However, in 2020 there was a sharp increase to 6.91 percent, reflecting the significant impact of the economic slowdown caused by the COVID-19 pandemic on the labor market in North Sumatra Province.

From 2021 through 2024, the open unemployment rate in North Sumatra Province showed a gradual downward trend, driven by the recovery of economic activity and the adaptation of business sectors to post-pandemic conditions. Nevertheless, this decline in the unemployment rate proceeded relatively slowly, and by 2024, it had returned to a level nearly identical to pre-pandemic conditions. This phenomenon indicates that the economic recovery has not yet been fully accompanied by an optimal increase in labor absorption.

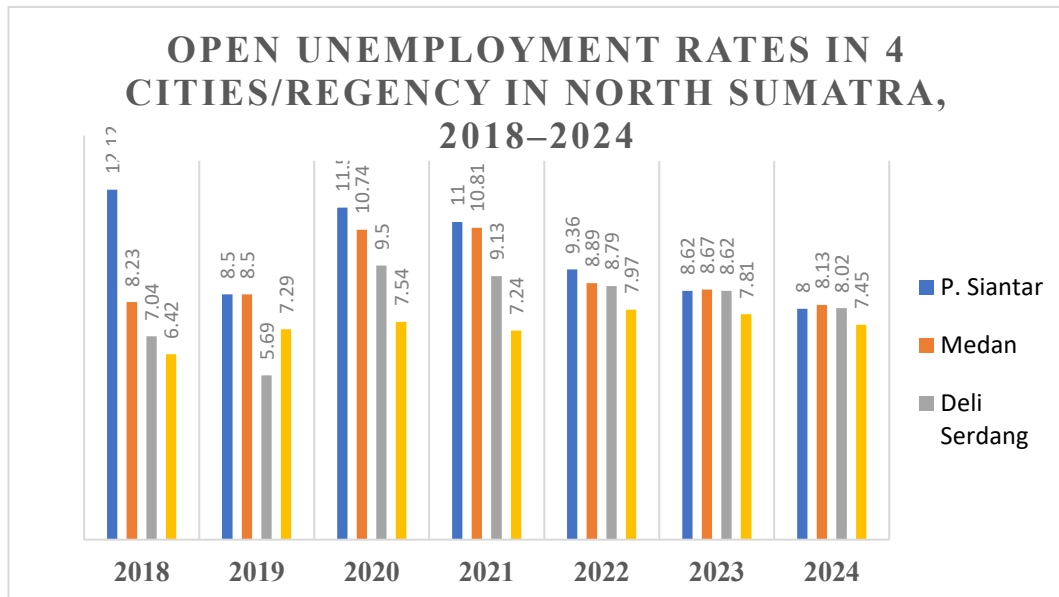
The development of the open unemployment rate at the provincial level does not occur uniformly across all regencies and cities. Each region has distinct economic characteristics, leading sector structures, minimum wage policies, and inflation dynamics, resulting in varied labor market responses to economic shocks and the recovery process. This situation causes fluctuations in the open unemployment rate at the district/city level to be higher or lower than the provincial average.

These differences are clearly evident in the four cities and regencies with the highest unemployment rates: Medan City, Deli Serdang Regency, Pematangsiantar City, and Central Tapanuli Regency. The selection of Medan City, Deli Serdang Regency, Pematangsiantar City, and Tapanuli Tengah Regency as research subjects was also based on the empirical observation that these four regions consistently rank among those with relatively high open unemployment rates compared to many other regions in Indonesia, particularly among regencies and cities outside Java.

Data from the Central Statistics Agency (BPS) indicate that unemployment rates in the City of Medan and the City of Pematang Siantar have been above the national average in recent years, and tend to be higher than those in most regencies

and cities in North Sumatra Province. Deli Serdang Regency and Tapanuli Tengah Regency, despite having different economic structures, also exhibit significant fluctuations in unemployment, particularly during the crisis period and the post-pandemic era.

Figure 1.2 Open Unemployment Rates in 4 Cities/Regencies in North Sumatra



Source: Central Statistics Agency, Processed Data

During the 2018–2024 period, the development of the open unemployment rate (OUR) in Medan City, Deli Serdang Regency, Pematang Siantar City, and Tapanuli Tengah Regency showed fairly fluctuating dynamics with distinct characteristics in each region. Nevertheless, there is a relatively similar trend, namely a significant increase during the COVID-19 pandemic in 2020–2021 and a gradual decline through 2024 in line with the economic recovery process. These changes reflect that regional labor market conditions are heavily influenced by various macroeconomic factors, such as economic growth, minimum wage policies, and inflation dynamics that affect economic stability and household purchasing power.

The cities of Medan and Pematang Siantar experienced a relatively high surge in unemployment rates during the pandemic crisis, and the rate of decline proceeded more slowly compared to the recovery of regional economic growth. This situation reflects the phenomenon of “*jobless growth*,” a scenario where economic growth and increases in the minimum wage have not yet fully succeeded in optimally boosting labor absorption. In this context, inflation also plays a significant role in influencing labor market dynamics. Rising inflation can lead to higher prices for goods and services, which ultimately reduces public purchasing power and increases production costs for businesses. When production costs rise due to inflationary pressures, companies tend to hold back on business expansion or even reduce their workforce to maintain operational cost stability. Therefore, uncontrolled inflation has the potential to slow job creation even as economic growth continues.

Meanwhile, Deli Serdang Regency showed labor market conditions that had improved prior to the pandemic; however, after 2020, the unemployment rate remained at a relatively high level despite the economic recovery. One factor influencing this relationship is inflation dynamics, which affect price stability and cost structures within the local economy. When inflation rises significantly, businesses tend to face higher cost pressures, both in terms of raw materials and other operational costs. Consequently, the business sector’s ability to expand production activities and absorb labor becomes limited. This situation can slow the labor market recovery process even though economic growth indicators show a positive trend.

Unlike the other three regions, Tapanuli Tengah Regency exhibits a more stable unemployment rate at a lower level, despite experiencing fluctuations throughout the study period. This stability may indicate a relatively better balance between regional economic growth, minimum wage developments, and relatively controlled inflation. Stable inflation can create a more conducive economic environment for production and investment activities, thereby providing businesses with certainty in planning long-term economic activities. Under controlled inflation, household purchasing power also tends to be more stable, ensuring that demand for goods and services remains sustained and driving the continuity of production activities and labor absorption.

Overall, the differing patterns of open unemployment rates across these four regions reflect that changes in unemployment levels cannot be fully explained by a single factor. Unemployment dynamics result from the complex interaction of various macroeconomic variables, particularly economic growth, minimum wage policies, and inflation rates. In theory, economic growth is expected to increase production capacity and expand employment opportunities. However, these effects can be influenced by inflationary conditions that affect price stability, public purchasing power, and corporate production cost structures. High economic growth does not guarantee a reduction in unemployment rates if it is not accompanied by price stability and conducive economic conditions.

As we approach the end of 2024 through early 2025, these conditions further underscore the existence of structural challenges in labor absorption at the regional level. Stable economic growth and increases in the minimum wage have not yet

fully translated into improvements in the quality or quantity of job opportunities, particularly in the formal sector. Additionally, inflation fluctuations are a factor that requires attention as they can affect regional economic stability, public purchasing power, and investment and production decisions by businesses. Unstable inflation has the potential to create economic uncertainty, which could ultimately hinder the creation of new jobs.

This analysis of the effects of economic growth, the minimum wage, and inflation on the unemployment rate is crucial for understanding the dynamics of the labor market at the regional level. The findings of this study can also serve as a basis for formulating more effective economic and labor policies, particularly in creating economic stability, increasing labor absorption, and promoting economic growth in North Sumatra Province.

1.2 Research Questions

Based on the background described above, and to clarify the focus and direction of the research, the research questions can be formulated as follows:

1. Does economic growth affect the unemployment rate in North Sumatra?
2. Does the minimum wage affect the unemployment rate in North Sumatra?
3. Does inflation affect the unemployment rate in North Sumatra?

1.3 Research Objectives

The objectives of this study are as follows:

1. To determine the effect of economic growth on the unemployment rate in North Sumatra.

2. To determine the effect of the minimum wage on the unemployment rate in North Sumatra.
3. To determine the effect of inflation on the unemployment rate in North Sumatra.

1.4 Scope of the Study

This study focuses on analyzing the factors influencing the open unemployment rate in four selected regions in North Sumatra Province, namely the City of Medan, Deli Serdang Regency, the City of Pematang Siantar, and Tapanuli Tengah Regency during the 2018–2024 period. The selection of this time period is intended to comprehensively capture regional labor market dynamics, including conditions prior to the COVID-19 pandemic, during the economic shock, and in the economic recovery phase, so that the research results are expected to provide a more complete picture of structural changes in the labor market.

This study does not address other factors beyond the established variables, such as educational attainment, detailed economic sector structure, investment, poverty, labor migration, or labor quality. Furthermore, this study does not examine labor policies from a normative perspective or evaluate the implementation of government programs; rather, it focuses on the statistical impact of economic variables on unemployment rates.

1.5 Research Benefits

This study offers benefits both theoretically and practically. Theoretically, it enriches the body of knowledge, particularly in the fields of regional economics and labor economics, by providing empirical evidence regarding the relationship

between economic growth, minimum wage, inflation, and open unemployment rates at the district/city level. Through a quantitative approach based on panel data, the results of this study not only reinforce existing theories but also provide a more contextual understanding of labor market phenomena in regions with distinct economic characteristics.

In practical terms, the results of this study are beneficial to various parties, such as local governments, academics, business actors, and the public. For local governments, particularly in the City of Medan, Deli Serdang Regency, the City of Pematang Siantar, and Tapanuli Tengah Regency, the empirical findings of this study can serve as a basis for formulating more effective development policies, including minimum wage policies, the development of labor-intensive sectors, and the improvement of the quality and absorption of the local labor force. For academics, this study can be used as teaching material or a reference for further research in the field of regional development economics.

The results of this study can provide an overview of regional labor market dynamics to assist in investment decision-making and workforce planning. Meanwhile, for the public and the workforce, this study offers a better understanding of the economic factors influencing unemployment rates, thereby supporting efforts to improve well-being and foster inclusive long-term regional economic development.