

CHAPTER I INTRODUCTION

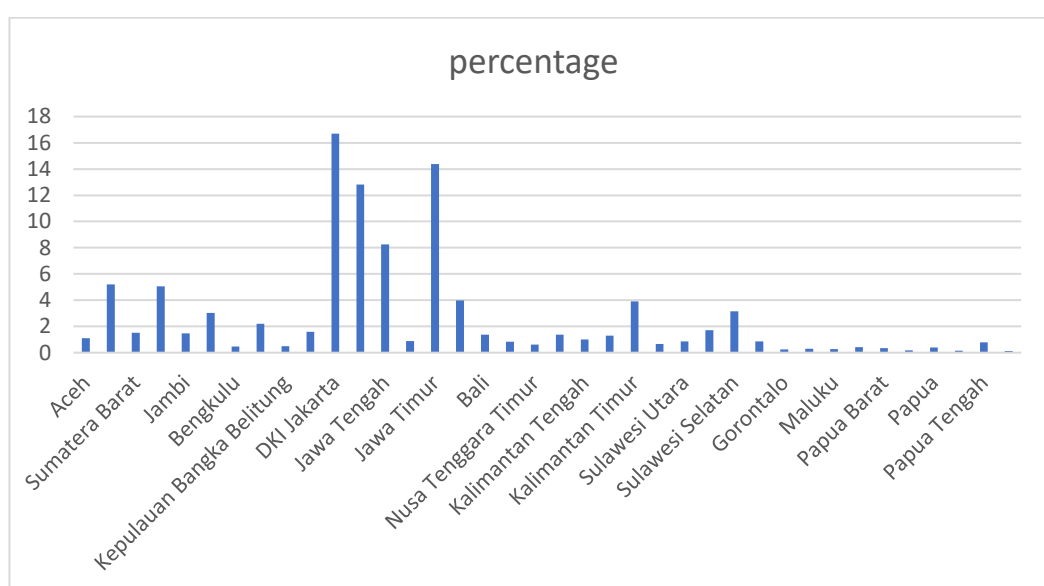
1.1 Background

Regional economic growth is an important benchmark for assessing the success of a province's economic development. One of the primary indicators frequently used is the Gross Regional Domestic Product (GRDP). The Gross Regional Domestic Product (GRDP) represents the total value added generated by all business units within a region, or can be defined as the total value of final goods and services produced by all economic actors in that region. A high rate of economic growth in a region reflects the improving economic activity in that region. This economic growth can be observed through the growth rate of RDP at constant prices. As economic growth increases, the production of goods and services also rises, thereby creating the capacity to absorb a larger workforce (Widiyanto and Arianti, 2022).

One type of GRDP is GRDP at constant prices (Produk Domestik regional bruto atas Dasa Harga Konstan,ADHK). This type of GRDP illustrates *real* economic growth after accounting for the effects of inflation. GRDP at constant prices reflects the value added of goods and services produced in the region over a specific period. In Indonesia, East Java Province occupies a strategic position with a strong manufacturing and agro-industrial base. For example, according to the East Java Central Statistics Agency (Badan Pusat Statistik,BPS), in 2024 the economy of East Java reached approximately Rp 1,935,810 billion, with an annual economic growth rate of 4.93%

(year-on-year). This trend indicates post-pandemic economic recovery and expansion, although East Java experienced a contraction in 2020 due to the impact of COVID-19. The consistent growth of the GRDP indicates a fairly strong economic driving force in East Java, supported by increased production capacity as well as both domestic and export demand.

Figure 1. 1 Percentage distribution of (Produk Domestik regional bruto atas Dasar Harga Konstan,ADHK GRDP) by province



Source : BPS Indonesia

This graph shows the percentage distribution of Gross Regional Domestic Product (GRDP) at constant prices by province in Indonesia in 2024. Based on the graph, it can be seen that East Java Province is one of the provinces with a significant GRDP contribution, at 14.39%. This positions East Java as the province with the second-largest contribution, following DKI Jakarta, which ranks first with a contribution rate of 16.71%. This indicates that East Java plays a strategic role in the national economic structure.

The magnitude of East Java Province's GRDP contribution reflects the high level of economic activity taking place in the region, supported by the diversity of economic sectors including the primary, secondary, and tertiary sectors. This situation indicates that East Java serves not only as a center for goods production but also as a key provider of services and a distribution hub at both the regional and national levels.

With its relatively high GRDP contribution, East Java Province can be considered one of the driving forces behind national economic growth. Therefore, focusing research on East Java Province is relevant, given that the dynamics of this region's economy have a significant impact on the Indonesian economy as a whole. Further analysis of the factors influencing GRDP in East Java Province is expected to provide a comprehensive picture of the region's economic performance and potential.

Within the framework of macroeconomic theory, output growth (GRDP) is explained by a combination of demand-side and supply-side factors. *Neoclassical* economic growth theory (the Solow model) explicitly states that output is determined by the accumulation of capital, labor, and technological progress (Adipathy and Armunanto, 2025). Based on a review of economic growth theory and the specific conditions of East Java, this study focuses on three main variables: investment which includes foreign direct investment (FDI) and domestic investment (DDI) exports, and the labor force. These three factors are considered relevant because they align with the neoclassical economic concept that output is determined by the accumulation of capital and labor. Based on this framework, this study uses GRDP as the dependent variable (Y), while the independent variables

(X) include investment, exports, and labor, which are theoretically and empirically linked to regional economic growth.

GRDP represents the accumulation of economic value added generated by all economic actors within a region, encompassing the total value of final goods and services produced in a specific administrative area (Widiyanto and Arianti, 2022).

The development of East Java's Gross Regional Domestic Product (GRDP) during the 2011–2024 period shows that, overall, the condition of East Java's GRDP underwent several distinct phases during the observation period. The initial observation period (2011–2015) showed relatively slow but stable growth. East Java's Regional Gross Domestic Product (RGDP) increased from 366,968 billion in 2011 to 1,331,376 billion in 2015. The average annual growth during this period can be categorized as sustained growth at a consistent rate, reflecting regional economic stability in the aftermath of the 2008 global crisis. This phase demonstrated efforts toward regional economic recovery and consolidation following the impact of the global economic shock.

During the 2016–2018 period, East Java's economy experienced a more pronounced acceleration in growth. The Regional Gross Domestic Product (PDRB) increased from 1,405,561 to 1,563,441 billion rupiah, indicating a significant rise in regional economic activity. This increase can be attributed to higher investment activity, increased domestic consumption, and rising exports, which drove overall regional economic growth. This period of acceleration reflected improved economic conditions, supported by various incentives and policies designed to foster economic growth at the regional level.

Entering the 2019–2020 period, East Java experienced a slowdown in economic growth, marked by a contraction in GRDP compared to the previous period. This situation can be attributed to several external factors, such as escalating global trade tensions and the onset of the COVID-19 pandemic in 2020, which placed significant pressure on regional economic growth. This phase highlighted the regional economy's vulnerability to external shocks that could hinder the growth momentum that had previously been established.

Following the slowdown, East Java demonstrated economic recovery with a steadily increasing growth trend from 2021 through 2024. The GRDP reached 1,935,810 billion in 2024, reflecting a solid recovery from the impact of the COVID-19 pandemic and an acceleration of regional economic activity toward the end of the observation period. This phase of recovery and expansion demonstrates the regional economy's adaptability and the effectiveness of recovery policies in reigniting economic growth following a temporary contraction.

Overall, East Java's ADHK GRDP indicates that East Java, as one of Indonesia's major economic hubs, possesses the capacity for sustainable growth despite facing several external challenges. This growth pattern is relevant for further analysis of regional economic dynamics and the identification of determinants of GRDP growth, such as investment, exports, and labor.

One factor believed to influence GRDP is investment. Investment (X1) plays a crucial role in increasing production capacity, creating jobs, and driving regional economic growth. In East Java Province, trends in realized investment

show interesting dynamics in tandem with rising industrial activity and infrastructure development.

Overall, investment realization in East Java Province shows a very positive trend, with an upward trajectory from 2011 to 2024, although it experienced fluctuations in certain years. In 2011, total investment realization stood at Rp21,495 billion, then increased significantly to Rp67,026 billion in 2013. However, there was a decline in 2014 to Rp57,420 billion, before gradually rising again to reach Rp72,898 billion in 2016.

During the 2017–2018 period, realized investment declined again, with the lowest value in the past decade recorded in 2018 at Rp51,200 billion. This situation can be attributed to various factors, including global economic uncertainty and the dynamics of investment policies during that period. However, since 2019, investment has shown a consistent recovery, with realized investment rising steadily from Rp58.446 billion in 2019 to Rp78.346 billion in 2020.

The most significant upward trend occurred during the 2021–2024 period. Actual investment surged from Rp79.549 billion in 2021 to Rp110.328 billion in 2022, then continued to rise sharply, peaking at Rp147.326 billion in 2024. This rapid growth during this period indicates growing confidence among both domestic and foreign investors in East Java's investment climate. This is supported by post-pandemic economic recovery, infrastructure improvements, streamlined business licensing processes, and East Java's strategic position as an industrial and trade hub in Eastern Indonesia.

Overall, investment trends in East Java Province reflect the region's vast and continuously growing economic potential. The size of the domestic market, the availability of labor, and the support of local government policies have established East Java as one of Indonesia's primary investment destinations. Consequently, investment plays a crucial role as the primary driver of capital formation and regional economic activity, which is ultimately expected to contribute to the growth of East Java Province's Regional Gross Domestic Product (PDRB).

Overall, the increase in realized investment reflects the role of investment as a key factor in driving regional economic growth (Murtri Tri Handayani, 2019). This positive investment trend in East Java Province is expected to lead to increased production capacity, job creation, and growth in the Regional Gross Domestic Product (RGDP).

In addition to investment, another variable suspected of influencing the ADHK GRDP is net exports. During the 2011–2024 period, East Java Province's net exports were predominantly in deficit, with the value of imports consistently exceeding the value of exports throughout nearly the entire observation period. At the beginning of the observation period, the net export deficit stood at -Rp31.085 billion in 2011 and tended to widen further, reaching its deepest deficit in 2014 at -Rp74.905 billion. Nevertheless, there were several periods during which the deficit narrowed, such as in 2015–2016 and 2019, reflecting an improvement in East Java's international trade performance during those periods. The most significant development occurred in 2020, when net exports recorded a positive value of Rp5.120 billion for the first time the only trade surplus observed throughout the study period. However, this surplus did not persist, and net exports returned to a

deficit in subsequent years. By the end of the observation period, the net export deficit showed a narrowing trend, from -Rp49,551 billion in 2023 to -Rp20,379 billion in 2024, indicating an improvement in East Java Province's international trade competitiveness in supporting regional economic growth.

In addition to investment and exports, the labor force is also a key factor in the production process. The availability and quality of the labor force in East Java Province are expected to boost productivity and ultimately drive growth in the provincial gross regional domestic product (GRDP).

The number of workers employed in East Java Province during the 2011–2024 period shows a gradual upward trend over the long term, despite fluctuations in certain years. At the beginning of the observation period, the number of workers remained relatively stable before experiencing a more consistent increase from the middle of the period through 2024. This increase in the labor force reflects growing labor force participation and expanding economic activity (Riska Mulya Shari, 2022) in East Java Province. The relatively large labor force is a key factor in supporting production processes and the growth of regional economic sectors (Ali1, Baruwadi2 and Fitri Hadi Yulia Akib3, 2025). Therefore, the employed labor force is viewed as a variable that plays a crucial role in driving regional output growth and the formation of East Java Province's Regional Gross Domestic Product (RGDP), making it relevant for analysis in this study.

Nevertheless, the fundamental question that arises is to what extent these investments, exports, and labor contribute to economic growth in East Java; the

relationships among these variables may be conditional, depending on the quality of absorption, implementation, and the ability to sustain their growth.

Previous research conducted in East Java has yielded mixed findings. A study by (Alvaro, 2021) on the impact of investment, labor, and net exports on Indonesia's economic growth found that investment, labor, and exports do influence economic growth (Wibowo and Pramukty, 2023). However, another study was conducted during the 2011–2020 period showed different results, indicating that Indonesia's economic growth from 2011 to 2019 was significantly and positively influenced by investment and labor, whereas exports had no effect on Indonesia's economic growth (Fauzi and Suhaidi, 2022)

These differing research findings indicate that the observation period, methodology, and model specifications have a substantial impact on empirical results. Thus, a study using a more recent observation period (2011–2024) is highly relevant for providing an up-to-date picture of the relationship between investment, exports, and labor on economic growth in East Java. The 2011–2024 period was selected because it encompasses key phases in the economies of Indonesia and East Java, ranging from the post-2008 global crisis recovery, relatively stable growth during the administrations of Susilo Bambang Yudhoyono and the early years of Joko Widodo's administration, to the extraordinary challenges posed by the COVID-19 pandemic and the dynamic economic recovery.

Given the discrepancies in previous research findings, there remains a research gap that requires further examination. This study aims to fill that gap by utilizing the latest data from the 2011–2024 period in East Java Province, thereby

providing more up-to-date empirical evidence regarding the impact of investment, net exports, and labor on GRDP at Constant Prices.

Furthermore, the use of Regional Gross Domestic Product at Constant Prices (ADHK) with a base year of 2010 in this analysis holds significant methodological importance. ADHK-based Regional Gross Domestic Product enables an analysis of real economic growth without being influenced by price fluctuations, thereby providing a more accurate picture of the actual changes in the volume of goods and services produced in the economy (Central Bureau of Statistics, 2020). This differs from Regional Gross Domestic Product at Current Prices (ADHB), which reflects changes in both production volume and price levels.

1.2 Research Question

Based on the background described above, the research question for this study is:

1. Does investment affect the Gross Regional Domestic Product (GRDP) of East Java Province?
2. Do net exports affect the Regional Gross Domestic Product (RGDP) of East Java Province?
3. Does the labor force affect the Gross Regional Domestic Product (GRDP) of East Java Province?

1.3 Research Objective

Based on the background and research questions above, the objectives of this study are:

1. To analyze and demonstrate the effect of investment on the Regional Gross Domestic Product (RGDP) of East Java Province.

2. To analyze and demonstrate the effect of net exports on the Regional Gross Domestic Product (RGDP) of East Java Province.
3. To analyze and demonstrate the impact of labor on the Regional Gross Domestic Product (RGDP) of East Java Province.

1.4 Scope of the Study

The scope of this study is as follows:

1. The object of this study focuses on the Regional Gross Domestic Product (RGDP) as the dependent variable, as well as investment, net exports, and labor as independent variables.
2. The data used are annual data from 2011 to 2024 to cover periods of global crisis, growth, slowdown, pandemic, and recovery.
3. The annual data for the 2011–2024 period is secondary data obtained from the Indonesian Central Statistics Agency (BPS), the East Java Provincial Statistics Agency (BPS), and the Indonesian Investment Coordinating Board (BKPM).

1.5 Research Benefits

This research is expected to provide the following benefits:

1. Theoretical Benefits

To serve as a reference for future researchers who wish to examine macroeconomic variables in East Java Province using the most recent data.

2. Practical Benefits

To serve as strategic input for the East Java Provincial Government in formulating more effective economic policies.