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The Influence of Foreign Direct Investment and Minimum Wage Toward Disguised Unemployment In Indonesia

Imran Taufik

Department of Economics
Hasanuddin University
Makassar, Indonesia
e-mail: imran_taufik@yahoo.co.id

Nursini

Department of Economics
Hasanuddin University
Makassar, Indonesia
e-mail: nini_mahmud@yahoo.com

Rahmatia

Department of Economics
Hasanuddin University
Makassar, Indonesia
e-mail: rahmatiayunus@gmail.com

Sanusi Fattah

Department of Economics
Hasanuddin University
Makassar, Indonesia
e-mail: sanusi_fattah@fe.unhas.ac.id

Abstract—This paper focus to analyze the influence of foreign direct investment (FDI) and minimum wage toward directly or indirectly disguised unemployment in Indonesia through economic growth. Data from year 2011 to 2016 for thirty three provinces in Indonesia are used and analyzed using structural equation modeling (SEM). Results show that FDI and minimum wage have significance influence directly to disguised unemployment but they have no indirect impact to disguised unemployment through economic growth. The increasing of FDI and minimum wage will increase number of disguised unemployment. Presented information can be used by government in designing strategy or policy in handling unemployment in Indonesia.

Keywords—foreign direct investment, minimum wage, economic growth, disguised unemployment.

I. INTRODUCTION

One of the main problems in developing countries is unemployment. The unemployment rate can describe the economic performance of a country. Unemployment contributes positive or negative changes in the economy. The higher unemployment has resulted in an increase in social unrest and reflects the low welfare in the community.

Open unemployment is the main focus in discussing the problem of unemployment in Indonesia, but what is more urgent to solve is disguised unemployment. Disguised unemployment is more complex, in quantity far greater than open unemployment. Data from the Central Statistics Agency (2016) [1] in Indonesia open unemployment reached 7,030,000 people while disguised unemployment was more than 34,400,000 people from 118,410,000 people worked in 2016, with human resources and levels welfare is generally still low and far from a decent livelihood. Disguised unemployment reflects the conditions of poverty that existing in society.

II. LITERATURE REVIEW

The concept of disguised unemployment was first introduced in [2]. Then Reference [3] wrote about disguised

unemployment in his article "The Problem of Industrialization of Eastern and South-Eastern Europe". Finally it becomes a reference in labor issues in underdeveloped and developing countries.

Disguised unemployment is a labor surplus that continues to increase largely "disguised" through the division of labor, namely a reduction in the average working hours per worker [4]. Workers work under normal working hours (working < 35 hours/week). Other Reference [5] defines disguised unemployment, is residents who work do not do their jobs optimally for certain reasons. Disguised unemployment is likened to Navarete and Navarete in [6], as a situation where the transfer of a number of labor factors to a field or to another place will not reduce the overall output of the origin sector. This means that their marginal productivity works are zero or close to zero and even negative.

A. Linkages of Foreign Direct Investment, Economic Growth and Disguised Unemployment.

The growth model used in almost all developing countries is the aggregate growth model. This model uses a combination of several macroeconomic variables that most influence the level and rate of growth of national output, namely savings, investment, capital reserves, exports, imports, foreign aid and others. The aggregate growth model has similarities to ideas with the Harrod-Domar theory model. Harrod-Domar's theory that a decrease in the level of output and employment can be done in the presence of capital accumulation (investment) and savings.

Empirical studies find more FDI in developing countries. FDI can create new jobs, transfer of technology, knowledge and skills, and increase overall economic growth [7]. FDI against unemployment is not statistically significant, meaning unemployment is more influenced by other factors, economic growth plays an important role in its findings [8].

B. Minimum Wage Linkages, Economic Growth and Disguised Unemployment

The competitive labor market predicts that high minimum wages will cause job losses among low-skilled workers. The minimum wage set higher than competitive equilibrium wages will reduce employment for two reasons. First, employers will replace less skilled workers who are more expensive to use other inputs, such as equipment or other capital. Second, higher wages imply higher prices, which ultimately reduces the demand for products and labor [9].

Wage rate reflects the level of productivity of labor contributed by labor to corporation, with rising wage levels expected to increase labor productivity will also increase so that it will increase the corporation's output. When wage levels rise and are followed by increases in productivity of workers in almost all sectors it will affect real GDP [10].

C. Linkage of Economic Growth and Disguised Unemployment

Okun (1962) first discovered empirically between unemployment and output and its relationship. Theoretical propositions relating to output and unemployment are generally known as "Okun Law". Economists mention Okun's Coefficient in empirical relationships but there is no consensus on the Okun coefficient value. Okun Law is an empirical study that measures the correlation between the unemployment rate deviation from its natural level and the output growth of its potential. The existence of Okun's law explains the relationship between unemployment and economic growth and vice versa, the original manifestation is pure statistical relations [11,12].

III. RESEARCH FRAMEWORK

A. Conceptual Framework

Economic theory related to the relationship between unemployment and economic growth is Okun's law. Okun's law states that there is a linear negative relationship between unemployment and economic growth. So the results of empirical studies have found an influence of economic growth on unemployment, but the effects are different and vary from country to country.

Athukorala in [13] explain that FDI is able to provide basic infrastructure facilities such as; capital, technology, skills, managerial aspects, entrepreneurial ability and market access. The interdependence between FDI and labor varies from country to country (depending on the economic structure and type of foreign investment) and also from period to period. Economic structures can change significantly over a long period of time [14].

The theory that explains the existence of unemployment due to wage rigidity or failure of wages adjusts to the supply of labor, the same as the demand. Low wages encourage corporation's to use more labor so that they can reduce unemployment and vice versa [15].

B. Research Framework

Based on the results of the explanation above, the framework of this research is shown in Figure 1.

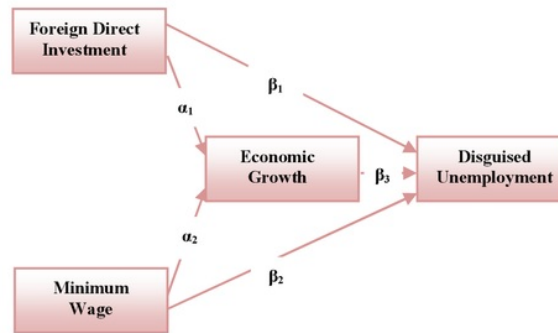


Fig. 1. Research Framework

C. Data and Method

This research model uses Structural Equation Modeling (SEM) using path analysis. The unit of analysis is the province in Indonesia, taking a sample of 33 provinces from 34 provinces in Indonesia except the province of North Kalimantan. The data of this study are panel data for 2011-2016 obtained from [1,5,16].

IV. RESEARCH RESULTS

A. Overview

Based on the results of data collection related to this study, it is described in general on variable data used in Indonesia.

The data are graphically shown in Fig. 2-6. From the figures, there is some information that can be used as an initial analysis. For example in Figs. 2 and 3, in Fig. 2 yearly values for FDI tend to increase meanwhile economic growth tends to decrease during period of year 2011-2015. Next, in year 2015-2016, realization of FDI decrease from 400.67 IDR (in trillion) becomes 258.97 IDR (in trillion), meanwhile economic growth increase from 4.79% to 5.07 %. In Fig 3, minimum wage tends to increase by year under observed period.

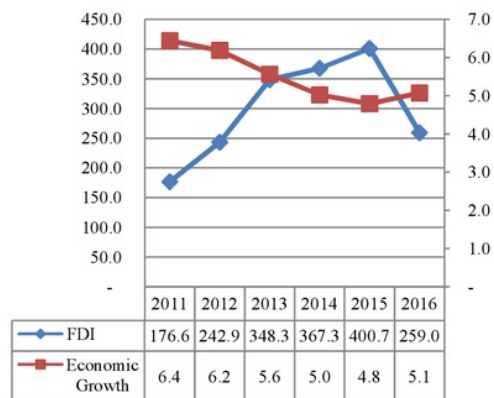


Fig. 2. FDI and annual economic growth values

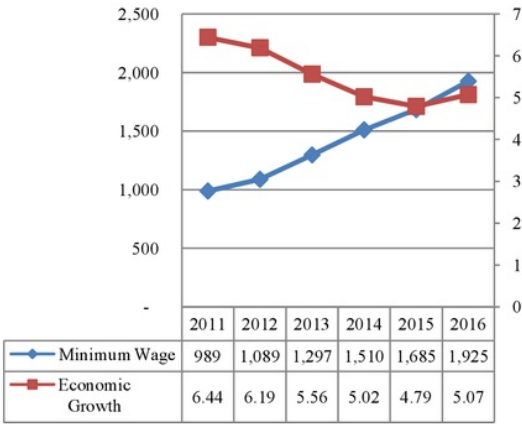


Fig. 3. Minimum wage and annual economic growth values

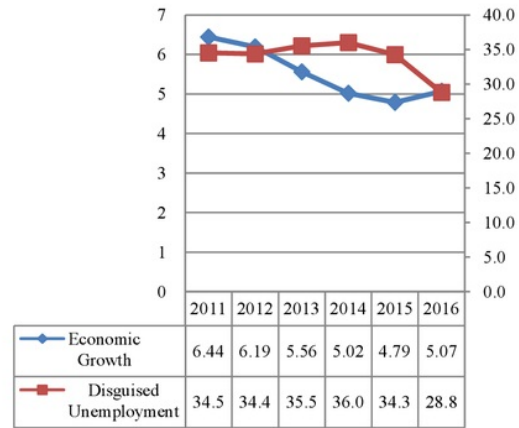


Fig. 6. Economic growth and annual disguised unemployment values

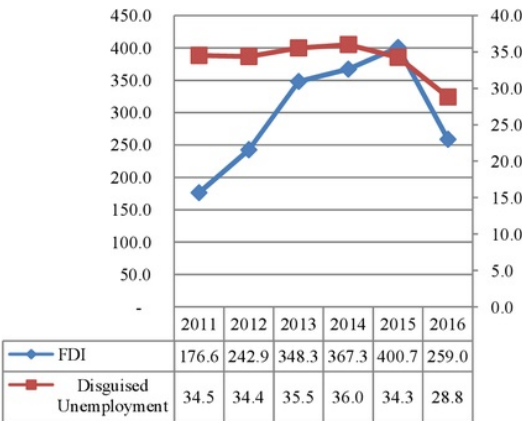


Fig. 4. FDI and annual disguised unemployment values

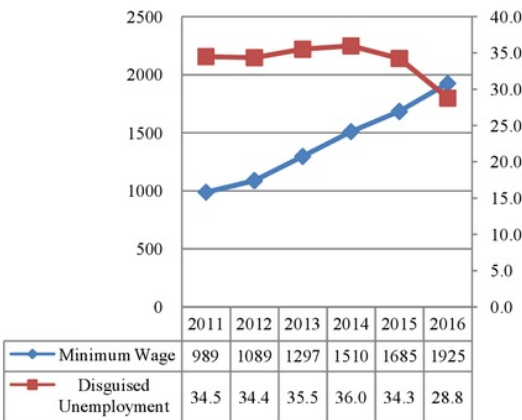


Fig. 5. Minimum wage and annual disguised unemployment values

B. Model Analysis

The model built in this study is stated to be fit if it meets the requirements (Goodness of Fit Index) as required by Structural Equation Modeling (SEM). The results of analysis can be summarized as seen in Table I.

TABLE I. RESULTS OF GOODNESS OF FIT MODEL INDEX

Goodness of Fit Index	Cut Off Value	Output
Goodness of Fit Index (GFI)	> 0.90	1.000
Comperative Fit Index (CFI)	> 0.95	0.990
Normed Fit Index (NFI)	> 0.95	1.000
Incremental Fit Index (IFI)	> 0.95	1.000

Based on Table 1 GFI value of 1.000 indicates that the model built in this study has a very high match. The CFI value is 1.000, NFI is 1.000, IFI is 1.000 indicating that the model in this study is model fit.

C. Results of Estimates and Functional Effects between Variables

Results for direct and indirect influence between variables in the model are shown in Table II and III, respectively.

TABLE II. DIRECT ESTIMATION RESULTS BETWEEN VARIABLES

Variable	Coefficient	Sig. (p)	
Foreign Direct Investment	Economic Growth	0.000	0.444
	Minimum Wage	0.000	0.055
Foreign Direct Investment	Disguised Unemployment	0.813	0.001
	Minimum Wage	16.954	0.002
	Economic Growth	899.141	0.542

TABLE III. INDIRECT ESTIMATION RESULTS BETWEEN VARIABLES

Variable		Coefficient	Sig. (p)
Exogen	Endogen		
Foreign Direct Investment	Disguised Unemployment through Economic Growth	-0.008	0.633
Minimum Wage		-0.449	0.561

V. DISCUSSION OF RESEARCH RESULTS

A. The Direct Effect of Foreign Direct Investment (FDI) on Economic Growth

The effect of FDI on economic growth is insignificant as seen in the Table II. It can be caused FDI entering Indonesia is still partly limited to technology and management transfers so that it has not been able to fully encourage and develop the domestic industry so that the direct effect of FDI as a pillar of economic growth does not have a significant impact. This is also because the amount of FDI is still relatively small, fluctuating and tends to decline.

B. Direct Effects of FDI on Disguised Unemployment

The effect of FDI on disguised unemployment has a positive and significant effect (Table II. - significant). This is presumably because more inflows of FDI are capital and technology intensive (capital intensive), not oriented towards labor intensive industries that use a lot of labor. Capital and technology intensive industries tend to employ workers who have expertise and work experience. Unemployment is increased due to the division of labor and reduction of working hours (working < 35 hours/week) based on his expertise.

C. Indirect Effects of FDI on Disguised Unemployment through Economic Growth

The indirect effect of FDI on disguised unemployment through economic growth is insignificant (Table III. - insignificant). It is suspected that FDI does not meet the additional domestic investment and is not connected to the domestic industry so that the domestic industry does not grow and develop --- not giving birth to new industries. FDI entering Indonesia has more effect on technology transfer and management aspects so that it has a real impact on reducing disguised unemployment through economic growth.

D. Direct Effect of Minimum Wages on Economic Growth

The effect of minimum wages on economic growth has a insignificant effect (Table II. - insignificant). This can happen because the minimum wage burdens the companies in the long because it increases production costs, especially in the small and medium business sector. The small and medium enterprises (SMEs) sector does not develop so that it orders the overall economic growth considering that the number of micro, SMEs in Indonesia is far more than the large business category.

E. Direct Effect of Minimum Wages on Disguised Unemployment

The direct effect of minimum wages on disguised unemployment has a positive and significant effect (Table II. - significant). This happens because with the increase in minimum wages, workers who work according to normal working hours (working ≤ 35 hours/week) will be interested in becoming workers who do not work according to normal working hours (working < 35 hours/week). This is because the owners of capital/entrepreneurs or companies are of the view that there is an excess of labor that needs to be reduced through the division of labor by reducing the average working hours per work thereby increasing the number of disguised unemployment.

F. Indirect Effects of Minimum Wages on Disguised Unemployment through Economic Growth

The indirect effect of the minimum wage on disguised unemployment through economic growth is not significant or there is insignificant influence (Table III. - insignificant). The minimum wage increase does not improve the overall economic welfare of workers and their families. This is because the increase in minimum wages in Indonesia is measured not based on labor productivity but based on the level of inflation and economic growth. The increase in workers' income due to rising minimum wages has no impact on disguised unemployment through economic growth.

VI. CONCLUSION

Based on the results of the study, it can be concluded that:

- 1) FDI has a positive and significant effect on disguised unemployment in Indonesia and is insignificant through economic growth.
- 2) Minimum wages have a positive and significant influence on disguised unemployment in Indonesia and are insignificant through economic growth.

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