CHAPTER I

INTRODUCTION

1.1 Background

As an emerging country, Indonesia has experienced high economic growth for decades. Sustainable growth occurs as a result of progressive reformation which conducted by government over years in all sectors especially in fiscal and monetary sector. Reformation provides good business environment so that it encourages business activity (industrial sector), creates more jobs and accelerates the increase in output. That policy in turn has raised national economic welfare, increased purchasing power and changed standard of living to be better off. During that time, the number of population grouping in middle income level rose significantly and delivered income per capita to around USD 3,000. Increasing percentage of population with middle income level has boosted demand for goods and services which rise consumption spending and drive an escalation in output (Indonesian Data, 2010).

Post financial crisis which hurt Indonesia in 1998, provided a valuable lesson to the country about the important to have a good economic statistics. Learning from the crisis, Bank Indonesia began to develop and to enhance monetary and economic statistics. Data are obtained from company reports included bank and non bank. Other information must be acquired directly from several surveys which are conducted to monitor the movement of some macroeconomic indicators (Global Economics Prospect,2011).

In some ways, survey has several advantages compared with official data, especially in terms of speed of data acquisition time. In relation with the need of information for tracking possibility of economic crisis, Bank Indonesia carried out a few of surveys which can represent the economic growth such as business survey especially industrial activities, retail sales survey and consumer survey. In this case focus on consumer survey as a tool to track economic growth by capturing national consumption spending. After coming to power, the New Order government supervised the rapid industrialization of the Indonesian economy. These industries were often dominated by government enterprises (Global Economics Prospect, 2011).

Indonesian government still continues actively to create some efforts in order to be able to increase the growth of national economy. Those efforts yield a positive impact on generating the real sector and monetary affairs. Manufacturing industry sector, as one of the leading sector in contributing to the Gross Domestic Product with more than 25 percent contribution, is an important sector in the national economy. The growth of manufacturing industry production is necessary and mandatory to be monitored regularly to evaluate the direction of the economic growth(UNIDO,2000).

Government enterprises controlled all oil and natural gas processing and were important in other heavy industries, such as basic metals, cement, paper products, fertilizer, and transportation equipment. The improved economic climate for private investors following the trade deregulations is indicated in the importance of private ownership among the exporting manufacturing industries. The growing export manufacturing industries also offered many more employment opportunities than the heavy industries dominated by government and foreign joint ventures(TKN,2011).

So, Manufacturing Industry has important role in Indonesian economy in terms of its contribution to national output and employment. However, it is very fragile from internal and external shock. Thus, government intervention is substantially needed to offset the negative impact that might be occurred due to internal and external shocks.

Indonesia is currently the third fastest growing economy after India and China in the Group of Twenty (G20) industrialized and developing economies. The $512 billion economy expanded 4.4 percent in the first quarter from a year earlier and last month, the IMF revised its 2009 forecast for the country to 3-4 percent from 2.5 percent. Indonesia enjoyed stronger fundamentals with the authorities implemented wide-ranging economic and financial reforms, including a rapid reduction in public and external debt, strengthening of corporate and banking sector balance sheets and reducing bank vulnerabilities through higher capitalization and better supervision. Manufacturing industry makes a large contribution to Indonesian national output which is measured by the Gross Domestic Product (GDP) and the growth of the Indonesian economy is faster than before because of the growth of the Indonesian industry that increase significantly(Indonesian Economy,2011).

Therefore, based on that condition the writer interest to analyze and observe more ” Analysis Impact of Investment on the Growth Indonesian Manufacture Industry 1986-2010”.

1.2 Research question

There are several question post in this research:

1. How industrial development in Indonesia?
2. What is the Impact on investment on the growth of Indonesian industry?

1.3 Research Objective

The increase in poverty and the decline in income per capita were consistent with output contractions in many sectors as explained before. There were some reasons why the rupiah depreciation had caused a serious decline in Indonesia’s aggregate output. First, despite the fact that Indonesia has adopted import substitution strategy during the New Order era (1966-

1998), Indonesia, especially the industry sector, has been increasingly dependent on imported capital and intermediate goods, components and spare parts, and some processed raw materials. So, the rupiah depreciation prevented many export-oriented firms from gaining better world price competitiveness, one hand, while, on the other hand, many domestic market-oriented firms had to close down or to cut their production volume because they could not purchase any more very expensive imports. Second, many firms, especially conglomerates, during the New Order era had borrowed a lot money from foreign capital markets; mostly were short-term loans. They went bankrupt when rupiah depreciated and many other firms which had business relations with them were also in trouble. Third, the national banking sector was also collapsed. By the end of 1997 16 commercial banks were closed, and access to credit became very difficult and interest rate increased significantly (Indonesian data). This has contributed significantly to output contractions in many sectors in Indonesia (Tambunan,2011).

As well as disaggregating households, it also has a disaggregated industry and commodity structure, with 52 production sectors. The mapped sectors are focused on manufacturing industries, particularly the “priority” industries for Indonesia. The microeconomic behavior assumed within it is competitive profit maximization on the part of all firms and competitive utility maximization on the part of consumers. In the simulations reported in this sector, the markets for final outputs, intermediate goods and factors of production are all assumed to clear at prices that are determined endogenously within the model. Variations to this assumption are possible. For example, the possibility of unemployment can be introduced by varying the closure to make either real or nominal wages exogenous, thereby allowing the level of employment to be endogenously determined by demand. The nominal exchange rate between the rupiah and the US dollar can be thought of as being fixed exogenously. The role within the model of the exogenous nominal exchange rate is to determine, along with international prices, the nominal domestic price level. Given that prices adjust flexibly to clear markets, 1 percent increase in the rupiah/dollar exchange rate will result in 1 percent increase in all nominal domestic prices, leaving all real variables unchanged. In this case, the nominal exchange rate (rupiah/dollar) is a numeracy price in the model (Working Paper,2004).

Moreover, the main purpose of this thesis is analyzing and investigating the impact of investment on the growth of Indonesian Manufacture industry 1986 - 2010.

1.4 Identify of Research Problem

In the States that are developing, especially Indonesia in spurring economic development requires more funds, while the developing countries the State is experiencing a shortage of funds for it. Though the fund (investment) is very desirable to be able to create or increase economic growth. Similarly, with establishment of industry sectors, the role of investment is needed at all in raising the value-added industry sector in GDP. So, with the validity of the two variables is expected that the industry sector investments and the income will be a strong foundation for the next stage of development.

The development of this industry is affected by several factors, among others: economic growth, taxation, investment, and other locations. But in this context the writer discuss only the development of relationships with the investment industry. The formulation of the problem to be addressed is how to influence investment correlation with income or industry sector. So, the regression analysis will be performed.

1.5 Hypothesis

There are several hypotheses in this study:

1. Investment is one of important variable to increase revenue in industrial sector.

2. Investment gives positive and significant effect on the growth of Indonesian Manufacture Industry.

1.6. Limitation of study

1. This study examined the data of investment and growth of Indonesian Manufacture Industry at 1986 – 2010
2. In this study government role to attract the people to change the system of economy become industrialization system.

1.7 Organization of Thesis

The organization of this thesis consists of 6 chapters. The following brief content of the chapters are as follow:

Chapter I	:	Introduction
Chapter II	:	Theoretical Framework and Literature Review
Chapter III	:	Research Methodology
Chapter IV	:	The Effect of Investment Development on The Growth of Indonesian Manufacture Industry
Chapter V	:	Research Finding and Discussion
Chapter VI	:	Conclusion and Recommendation