CHAPTER I

INTRODUCTION

1.1 Background

Investment is one of the important things that influences the economic growth. Economic growth is determined by Gross Domestic Product (GDP). GDP is the sum of four categories of expenditures: consumption, investment, government purchase and net exports. GDP has functional relationship with price, quantity of commodity and level production in domestic market including the income that is received by foreigners who are working in domestic market.

The indicators of promoting domestic economic growths are labor training, market development, financial inflow, technology transfer, and skills. Its ability to minimize the shortages of financial resources and technology as these key resources can contribute to the human skill development that would lead to economic growth. The transfer of technology, skills, innovative capacity, organizational and managerial practices between countries is also enhanced through the activities of foreign direct investors. It will also be looking for investors, especially foreign and expatriate investors, who will bring significant capital and expertise on how to improve the financial performance of those institutions.

There are two types of investors. The first is individual investors mean individual who are investing on their own. It is also called retail investors. The second is institutional investors or investment companies, commercial bank, insurance companies, pension funds, and other institutional. Investors can use direct and indirect types of investing. Direct investment is realized financial market. It means investor can invest real assets; buy productive asset, build fabric, estate, and mining. It constains of as owner capital and owner of business which manages business and has responsibility on looses. In the other hand, indirect investment involves financial intermediaries or institutions. Investor invests the capital only moreover holds the stock and bond in short term period.

A research on FDI in India from 1991 - 2008 is using simple and multiple regression techniques that discover the main determinants of FDI in developing countries. They are inflation, infrastructural facilities, exchange rates, stable political environment, interest rates, labor costs and corporate taxes. A foreign investor is usually a foreign company that is incorporated under the laws of its host nation; however, foreign individuals are also acceptable (Hooda, 2009 as cited in FAROH and SHEN, 2015).

The importance of Foreign Direct Investment (FDI) as a source of capital in the developing world has increased significantly over the last couple of decades. By the dawn of the millennium more than half of all capital flows to develop countries took the form of FDI. The tremendous increase in FDI is undoubtedly related to the globalization of the world economy. A close look at the distribution of the estimated coefficients of explanatory variables of FDI indicates that, following the size of its market, a country's openness to trade is more "likely" to be correlated with its FDI than other potential determinants. The evidence should encourage policy makers, in order to increase FDI and to increase participation in the process if globalization as well as regional economic integration.

Indonesia has joined Asean Economic Community (AEC) and Indonesia will get the advantageous and disadvantageous of economic development from this agreement. AEC has established in 2015. It is a milestone in regional economic integration agenda in ASEAN. AEC is a part of community ASEAN (Association of South East Asian Nations) which has established on 8 August 1967 in Bangkok, Thailand by the Founding Father of ASEAN namely Indonesia, Malaysia, Philippines, Singapore and Thailand, followed by Brunei Darussalam on 1984, Vietnam on 1995, Laos and Myanmar on1997 and Cambodia in 1999. Until now, the total number of ASEAN is ten.

The AEC intends to encourage trade and investment among the 10 aforementioned nations and thereby strengthen the importance of ASEAN as a key global region. Furthermore, they aim to create a single, integrated market or economic unit, allowing free movement of goods, services, investment, capital and skilled labor across the boundaries of 10 countries.

Indonesia is rich in natural resources, coal, minerals like tin, gold, copper, nickel, bauxite, oil, gas and fertile land to support agricultural products. The archipelago's tropical weather and hugeland bank make it ideal for producing palm oil, rubber, coffee, cocoa and rice (the staple of most of the population). With an estimated population of 252 million, Indonesia is the fourth most populous nation in the world after China, India and the USA. The most populous cities are Jakarta, Surabaya and Bandung in Java, and Medan in Sumatra. There is also a lower and poor socioeconomic class that is growing alongside the middle class. The World Bank estimates that 200 million or 82% of Indonesia's population live on less than US$4 a day, with half of then on US$2. Those numbers are known to be under the poverty rate.

In addition, many companies are processing raw materials that have a low value in comparison with semi-finished goods and finished goods. The example is exports of rubber. In fact, we can make the rubber into tires and other purposes. Creating added value for its own export goods, however, we should be able to compete with products - foreign products which have high quality and cheap price. We have no issue with obstacle in the tariffs, but the issue only in the ability to compete with the exporting countries. As we know, Indonesia has followed many agreements with several developed and developing countries, such as AEC, IMT Growth Triangle, APEC, WTO and others.

Indonesia has a large domestic consumption bases, the country's middle class with increasing levels of disposable income beside purchasing power has grown substantially from 38% of the population or 81 million in 2003 to 56.6% or 131 million in 2010. A World Bank's report indicates that Indonesia needs 8 – 9% of economic growth in order to provide employment for an estimated 15 million new workers coming on line by 2020.

Thus, it based on background above about the investment we interest to study about:

"The Impact of Foreign Direct Investment on Indonesian Economic Growth (2000 – 2015)"

1.2 The Main Problem

There are several main problems that we have found in this study those as follows:

1. How the economic growth be influenced by Foreign Direct Investment, Interest Rate, Effective Exchange Rate, External Reserve and Trade Open?
2. How the Indonesian government stimulates the economic growth?

1.3 The Main Objectives

The main objectives of this study are:

1. To analyze the main economic variable which influences Gross Domestic Product of Indonesia those variables consist of Foreign Direct Investment, Interest Rate, Effective Exchange Rate, External Reserve and Trade Open.
2. To formulate the implication of research finding in Indonesia case.

1.4 Research Advantages

This study result will over several advantages to several users:

1. For student, in order to improve their own knowledge in analyzing the investment for speeding up Indonesian development process for government.
2. For government, it will be usefull as the basic in making police for the government.

3. For research, it uses this result for extend in term of economic growth, investment, interest rate, exchange rate, external reserves and trade open.

1.5 Research Hypothesis

Since the factors of investment are considered by many economists as the importance thing in development process of any country. Therefore, the hypothesis of this study will be as following: FDI has positive relationship to GDP. We consider that economic growth in case in Indonesia by this following variable: FDI, Interest Rate, Effective Exchange Rate, External Reserves and Trade Open. This is the secondary data by ASEAN's website, Bank of Indonesia (BI)'s website, International Financial Statistics (IFS)'s website, Bank for International Settlement (BIS)'s website, Federal Reserves Economic Data (FRED)'s website and others source data.

1.6 Writing Systematic

The study consists of 6 chapters from introduction to the conclusion and recommendation. The complete lists of this research are as follows:

Chapter 1: Introduction

In this chapter includes background of research why choose this topic, the main problem, the main objective, research advantage, and research hypothesis in this study.

Chapter 2: Theoretical Framework and Review Literature

This chapter includes the answer of hypothesis with reference and review that connect with independent and dependent variable theory.

Chapter 3: Research Methodology

This chapter tells about research methods, operational definition of the variables study, collection all data, source of data, method and data analysis method.

Chapter 4: General Overview

This chapter describes about the trend that happened in each variable include GDP, FDI, IR, EER, EXRV, and TO.

Chapter 5: Research Finding

This chapter consists of the outline result, discussion of description in object research, data analysis and description.

Chapter 6: Conclusion and Recommendation

This chapter consists of conclusion of analysis carried out, suggestion, and implication arising from the conclusion of problem.