

CHAPTER I

INTRODUCTION

1.1 Background

A country has each problem to be solved, especially from the economy side, due to the economic problems could cause other problems. Unemployment, economic growth and inflation is macroeconomics indicator that still need more attention in Indonesia because these problem will effect people activities as a whole. So, there some objective of the government which are to reduce unemployment, improve economic growth, decrease inflation and also improve the level of foreign direct investment.

The unemployment rate greatly will affect the economic growth of a country. The higher of unemployment rate, or more number of unemployed would decrease consumer spending and as a result will decline the sales in retail sector, which is have an impact on growth. The way to reduce unemployment are by increase the opportunity job, increase the skill of people/ human capital. When the people has a good skills, it will easier to have a job.

Economic growth is a process, there are developments or changes and use of time. Gross domestic product growth rate is used as proxy for economic growth and it is generally perceived that when economic growth takes place in the country, it increases of economic activity in the country, due to the employment increases. The increase in employment opportunities will enhance the purchasing power of the people in the country and as a result, consumption increases which leads to raise aggregate.

The condition of the Indonesian economy as a developing country has not yet reached steady state condition, in which an economy already in a stable State is not easily affected by the shock. Indonesia's economic growth is influenced by a variety of shocks.

Shocks such as the economic crisis in 1998, economic growth decrease become negative. The economic crisis in 1998 led to Indonesia's economy is in a recession. After 1998, economic growth in Indonesia is always increase year by year. In 2008, in which the world economy was in a recession (the global economic recession). The financial crisis not only hit Indonesia but also countries around the world. But Indonesia is ready to survive the crisis this time by learning from the experience of previous crises.

The data of gross domestic product in Indonesia is always increase and not only can explain as a welfare of the country, gross domestic product which is used to see the economic growth of the country but it is reflect to the level of unemployment. Based on Okun's Law there is negative relationship between economic growth and unemployment. It means, when the economic growth increase so the unemployment would decrease because, the level of output is depend on the amount of labor that used in production process. More output that produced, so more labor that used for production process, so unemployment will decrease.

During two decades FDI become main agenda in developing country, with a growing number of developing countries succeeding in attracting substantial and rising amounts of inward FDI. Economic theory has identified that FDI inflows may be beneficial to the host economy. The transfer of technology, skills, innovative capacity, organizational and managerial practices between countries is also enhanced through the activities of foreign direct investors. FDI also believed can increase the productivity, where if productivity increase employment also increase and unemployment will decrease (Smarzynska, 2002). 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.

Foreign direct investment (FDI) in Indonesia has always been move up and down every year. In 1986, FDI in Indonesia is Rp. 1.488.1 million and continuously increase until 1992 with the amount of FDI is Rp. 10.340. million and continuously fluctuate until 2006. In 2007, FDI increase significantly become Rp. 40.145.8 million in the next year FDI decrease because in 2008 there is global economic recession. From 2009 FDI increase continuously until 2015 which is reach 42.729.7 million.

Philips curve theory defined there is negative relationship between unemployment and inflation. If inflation rate increase, unemployment will decrease. So, the level of inflation become important indicator in order to decrease unemployment. Trend of inflation in Indonesia is fluctuate every year, but in 1998 inflation Indonesia increase significantly become 58.4% which is in the previous year 1997 inflation rate is just 6.2%. This is happen because at the time there is economic crisis, the price of goods and services are increase. In the next year, government with central bank are able in recovery the economic, even not clear yet. So, inflation in 1999 decrease become 20.5%. Inflation rate move up and down in the next year, until 2015 inflation in Indonesia is 3.35%, this the lowest rate of inflation but it's already predict by the government.

With the level of gross domestic product which is always increase every year it should be reduce the unemployment level, but the level of unemployment in Indoensia is still fluctuated and sometimes reach the high level. Inflation in Indonesia also still quite high it should be reduce unemployment but the unemployment is still high. This data is contradict with Okun's law theory and Philips curve, so this study is to analyze the relationship between

inflation, gross domestic product and also foreign direct investment to unemployment in Indonesia, therefore this thesis entitled:

**“THE RELATIONSHIP BETWEEN FOREIGN DIRECT INVESTMENT,
INFLATION AND UNEMPLOYMENT IN INDONESIA”**

1.2 Research Question

Unemployment is serious problem in economic activity not only for developing country but also for developed country, because unemployment can lead emergence of other problem. The problem that arise from high level of unemployment is not only from the economic side but also for society side. From the society side it can cause increase in crime, increase the inequality in the society and other problems. From the economic side it will cause continuously problems such as decrease in output, decrease in economic growth, decrease in welfare and poverty will increase.

The development of foreign direct investment, inflation and gross domestic product, and unemployment generally in Indonesia already explain. Here appear some question:

1. How is the development of the variables (Unemployment, Foreign Direct Investment, Inflation and Gross Domestic Product) in Indonesia?
2. What is the effect of foreign direct investment to unemployment in Indonesia?
3. What is the effect of the growth of economic to unemployment in Indonesia?
4. What is the effect of inflation to unemployment in Indonesia?

1.3 Research Objective

Based on main question that appear in this study, so there are some objective of this

study as follows:

- 1) To describe the development of the variables in this study (Unemployment, Foreign Direct Investment, Inflation, and Gross Domestic Product)
- 2) To examine the relationship between foreign direct investment and unemployment in Indonesia
- 3) To examine the relationship between inflation and unemployment in Indonesia
- 4) To examine the relationship between gross domestic product and unemployment in Indonesia

1.4 Research Advantages

This study hopefully expected to be useful for writer and the others interest parties. And the benefits of this research include:

1. As the partial fulfillment of Bachelor of Economics in Economic Faculty, Andalas University.
2. For the writer, improving my ability in writing report and doing research.
3. For the government, it will be recommended for the government to take the better policy in order to reducing unemployment rate and how to attract the investment in Indonesia.
4. For the investor, it will be a reference for investor to know the condition of economy in Indonesia. Then to decide the decision for investor to invest their money to Indonesia.
5. For the reader is expected to add understanding the economic analysis about relationship of foreign direct investment, inflation, GDP and unemployment.

1.5 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, and research advantage 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 UNEM, FDI, INF and GDP.

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.

