

CHAPTER I

INTRODUCTION

1.1. Background

Indonesia is a developing country and one of the characteristics of developing country is to growth and improve in every sector year by year to reach the economic welfare. Because Indonesia is one of the developing countries, so do happen with Indonesia that wanted to achieve the economic welfare of its people. To achieve these desired Indonesia is open themselves to cooperate with other nations in order to support nation building, especially in the national economy area and improving the economic growth in Indonesia to reach the economic welfare.

In order to increase the number of economic growth in Indonesia, the government should concern to the policy that supports for that condition, such as foreign direct investment, domestic investment, monetary policy were it could be accountable for several factors in the macro economy, trade, also export and import. Another supporting factor for the economic growth in Indonesia that is a technological progress and labor forces, (Tambunan, 2000).

Investment is one of the ways to achieve the economic welfare and sustainable economic growth. There are two kind of investments to support the economic sustainable for a country, first is the domestic investment and the second one is foreign direct investment. Domestic investment is an investment that came from the internal parties of a country such as government and foreign direct investment is the investment that came from a foreign investor. Foreign direct investment (FDI) offer for both the capital and technology that developing countries

lack. Therefore, there are broadly two channels were FDI can run. One is by offering a capital that builds up the productive capacity in the economy, and the other is by offering advanced technology and organizational needs where it will help to increase the efficiency of investment productivity, (Kipsang J.K, 2015).

As a developing country, Indonesia needs an improvement to reach the sustainable of economic growth, one of the most important thing is money because recently money becoming the measurement to see a country sustainability. Foreign direct investment is the platform for foreign companies to do the investment activity in Indonesia that affected to the money flow increase for Indonesia. In another way, it will follow by filling the business sectors and industries that not fully implemented by the national private sector, either technology, management, or capital reasons because another effect of foreign direct investment is transferring of knowledge, management skill, etc, (Panayotou, 1998).

Foreign direct investment in Indonesia started in the new orde era. In the period of 60's until reaching the highest level of FDI in 1997 before the crisis, where during the period 1990-1997 FDI is growth significantly in Indonesia with 3.3% growth in average (BKPM, 2000). Because of that achievement, Indonesia is one of the main targets for a foreign investor in pra-crisis era, but after the crisis happens to Indonesia in 1998 where it effect to decreasing number of the foreign investor. It happened for 3 years from 1998 until 2000 where the inflow of FDI in Indonesia decreases around 2.7% in average. However, after the crisis in Indonesia, the growth of FDI is tend to fluctuate. In 2001 FDI increase for 64.47% and follow by the next year decrease for 12.16% in 2002 with Rp. 9744.1 Million but, the growth of FDI have been changed into positive result followed by the other year

from 2009 FDI increase continuously until 2015 which is reached Rp. 42729.7 Million, where 0.19% growth per year, (BKPM, 2015).

Another way to maintain the sustainable growth of economic is by the labor force, by increasing the rate of labor force could affect the productivity level for a country, either positive or negative impact. It depends on the ability of economy in a country in terms of utilizing the rate of labor as productive as possible, (Todaro and Smith, 2006). The labor force is a subject also object for the sustainability of the economy, whereas the high number of labor involve or labor supports to the productivity it will affect to goods and services that will increase in the society, in this case, could support the economic growth in a country (Jhinigan, 2004:75).

According to Adam Smith, economic growth is necessary to have specialized or differentiated of work in order to achieve the productivity. Before executing the differentiate of work there is a capital accumulation where come from a society, another way the market have to be developed in order to achieve the production activity (Prayitno 1996:56). The number of population will also increase year by year, so do with labor force especially in Indonesia. The number of labor force Indonesia in 2009 increase 2.7 Million compare to 2008, from 165.56 Million to 168.26 Million people (BPS, 2009). Where around 67.6% from the number in 2009 is active labor, this example indicates that labor supply in Indonesia is always increasing as well as a number of population increase in Indonesia because Indonesia is one of the largest numbers of population in the world.

But Indonesia has a bad experience for the labor force, it happened during the crisis in 1998 until 2000, where the economic growth is decreasing also follow by the labor force. The labor force is decreased 20%, in the current condition

Indonesia had a better situation compare to the year of crisis, even though far to reach the expectation for a sustainability of the labor force, especially the number of an employee. In the last five-year number of the labor force increase, 0.2% in average it is quite significant followed by growth of GDP in the last five year is 0.23% in average, (BPS, 2015).

A better economic growth supported by a good resource of labor, so it is important for a country to increase the number field of work to support the labor force increases year by year. However, investment has an important role also in the growth of the economy in a country, because the higher number of foreign investor so it could reduce the number of unemployment by affecting the rate of an employee in the labor force.

The common challenge faced by developing county such as financial problem, income equity, environmental challenges, degree of governance, institutional capability, economic growth etc. Those problems mostly coming from internal part of the country, especially for the quality of labor or people itself (Bresser-Pereira, 2006). Indonesia is one of the developing countries, also happen with Indonesia that tend to have the internal problem that affect to several sector in Indonesia such as corruption, quality of education, infrastructure, etc. Even though there is still some problem that happen to Indonesia, however economic growth in Indonesia is relatively increasing so do happen with foreign direct investment and labor force. It is shows that commitment from government and people in Indonesia to face the challenge by creating the good policy, implement the strategy to increase the number of economic growth. Even create the relationship to other country to

support the development of Indonesia itself not just improving the infrastructure but also improving the quality of the labor in various way.

Based on above explanation, to prove is there any relationship between foreign direct investments and labor that effect to the economic growth in Indonesia. Therefore, researcher taking a title of the research:

“THE EFFECT OF FOREIGN DIRECT INVESTMENT AND LABOR TO ECONOMIC GROWTH IN INDONESIA”

1.2. Research Problem

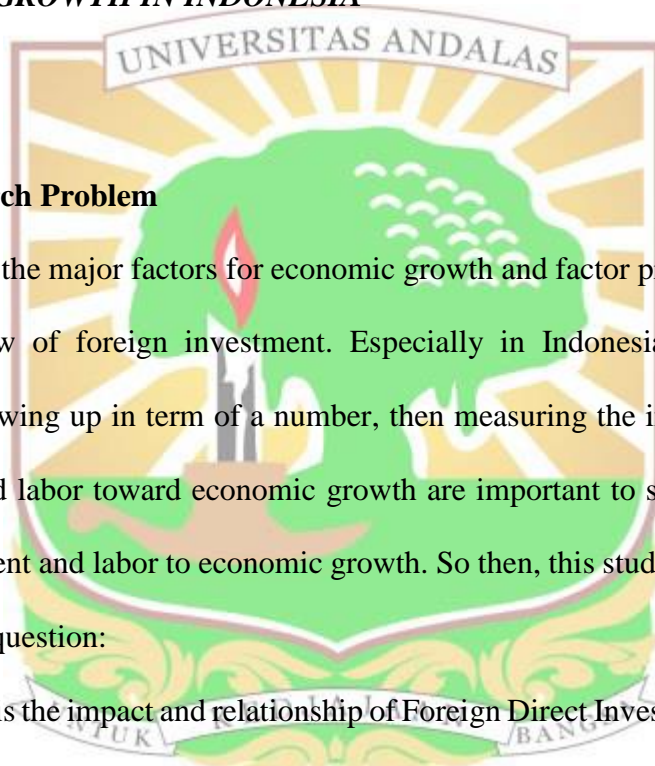
One of the major factors for economic growth and factor productivity is the level of inflow of foreign investment. Especially in Indonesia where foreign investor is growing up in term of a number, then measuring the impact of foreign investment and labor toward economic growth are important to see the impact of direct investment and labor to economic growth. So then, this study aims to answer the following question:

1. What is the impact and relationship of Foreign Direct Investment and Labor to Economic Growth in Indonesia during 1986 until 2015?

1.3. Research Objective

Based on the formulation of the problem, by using a reference point to solve the problem, researcher are trying to get and achieve the goal:

1. To analyze the impact and relationship of Foreign Direct Investment and Labor toward Economic Growth in Indonesia during 1986 until 2015.



1.4. Research Advantages

This study expected to be useful for the writer and the others interest parties.

There are some advantages of this research:

1. To see the condition of Foreign Direct Investment and Labor in Indonesia whether it could give contribution in enhancing economic growth in Indonesia.
2. As a reference for the government and the parties concerned, this study expected to provide an overview and knowledge of the influence of FDI and Labor toward economic growth Indonesia, and then it can serve as a point of comparison to determine the direction of policy in promoting economic growth in Indonesia.
3. As a source of information, studies and additional reference materials for students of the department of economics faculty of economic, University of Andalas, especially for a student who want to do further research.

1.5. Limitation of Study

For a more orderly study, the framework used in this study will be limited, among others:

1. This study only about the effect of foreign direct investment and labor to economic growth in Indonesia.
2. The data used in secondary data obtained from the Statistics Indonesia (BPS), World Bank and Bank of Indonesia.

3. The data are Gross Domestic Product (GDP), Foreign Direct Investment (FDI), Labor force (LF) and Capital Formation (CF) in Indonesia from 1986 to 2015 by yearly data.

1.6. Systematic Writing

The results of this study arranged in such a way that can be understood easily. Writing this thesis divided into six chapters with each chapter details the following:

Chapter I:

Introduction

This chapter contains the background description of the determinants of Foreign Direct Investment and Labor outlook, which have the correlation with the economic growth in Indonesia. This chapter also describes problems, research objectives, research advantage, limitation of the study and systematic writing.

Chapter II:

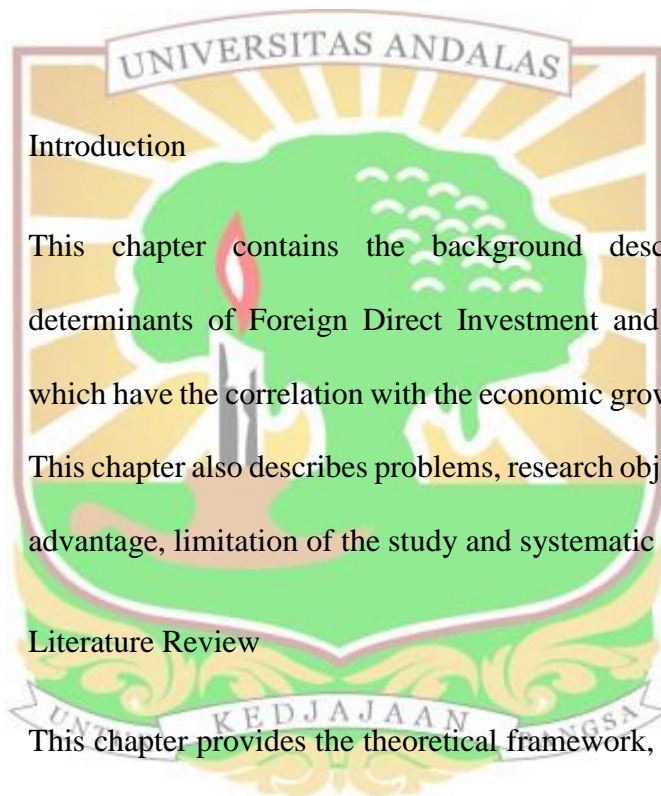
Literature Review

This chapter provides the theoretical framework, the definition of the variable and previous research with some review of past research that explains from empirical studies in the past as proven.

Chapter III:

Research Methodology

This chapter consists of several sub-chapters that include data and data sources, identification of variables, methods of data analysis and statistical analysis that consist of the preliminary test, co-



integration test, estimation of ARDL equation and classical assumption test.

Chapter IV: Foreign Direct Investment and Economic Growth in Indonesia

This chapter explains about the outlook and recent development of variables (Foreign Direct Investment, Labor Force, Capital Formation, and Economic Growth) in Indonesia related to research data from 1986 until 2015.

Chapter V: Empirical Result and Analysis

This chapter shows the output of research and the analysis of the processed data. An explanation of the result initiated an explanation of test result stationary, co-integration test, ARDL estimates and assumption of a classical test.

Chapter VI: Conclusion and Recommendation

The last chapter is consisting of conclusions and recommendations based on research and analysis of the results obtained from the data processing.

