

CHAPTER I

INTRODUCTION

1.1 Background

Development efforts undertaken by developing countries generally oriented in how to fix or regenerate living standards, it is necessary to accelerate the economic growth of large capital. But, the deficiency of capital in one's country will be caused to low productivity within the economy resulting in the low income received by the community. Furthermore, the low income limitations will affect the savings required in subsequent period investment activities.

The characteristic of underdeveloped countries is "less capital" or "low savings" and "low investment", not only supplies very low capital however the rate of capital establishment is very lowly money. Scarcity of capital instruments are another common characteristic of underdeveloped countries is defined as an economy that "capital poor" or the "low savings and investment", not only supplies very little capital but capital accumulation levels were very low. Bank of Indonesia show Gross investment is only around 5% to 6% of gross national income, whereas in industrialized countries is approximately 15% to 20%.

Investment is one of the important things that influences the economic growth. Economic growth is determined by Gross Domestic Product (GDP). According to Case and Fair (2009), 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 contains of as owner capital and owner of business which manages business and has responsibility on losses. 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.

The research by Mukolo M.O, Olatu.J.A and Awousi C.T (2013) about Assessment of The Impacts of Foreign Direct Investment and Interest Rate on the Growth of Nigerian Economy, the result is FDI has both short run and long run significant impact on GDP of Nigeria. It is important source of improving

efficiency of the productive sectors of an economy though competition stimulates economic progress, creation of jobs and forecasting growth in the host economy.

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 evidence should encourage policy makers, in order to increase FDI and to increase participation in the process of globalization as well as regional economic integration (Mansour, 2006).

International Financial Statistics (IFS) data show that interest rate in Indonesia over quarterly period 2000 until 2016 is fluctuate. It can see by changing rate of interest rate at that period. At during quarter 2000 – 2001 in term of economic recovery from crises, interest rate in Indonesia recorded tends to increase in first quarter until last quarter 2001 from 17.8% until 19.2%, and then after that interest rate tend to decrease to 13.7% in the third quarter in 2005. It show that fluctuate of interest rate data probably indicated influence to attract the growth of Indonesian economy.

According to data of Bank International Settlements (BIS) data show the value of exchange rate in Indonesia still in the worse condition after the effect of monetary crisis in 2000, then in 2001, the currency of Rupiah is appreciate to 4.1% from 4.3%. However, in 2002 – 2007, the currency of Rupiah is fall until 4.6%. It is not stop here, in 2011 and 2012, the exchange rate of Indonesia is depreciate too at level 4.6% and 4.5%. It still depreciate of currency.

Foreign reserves include gold and other central bank assets which come entirely within its control and it is easy to trade on international financial markets. In this variable, the proxy of external reserve is reserve asset named Special Drawing Right (SDR). It is like a gold otherwise it not real. It just adjusted by currency of dollar. Actually, the condition of external reserves in Indonesia tend to be increase each year. There is no problem with the reserve in Indonesia. Indonesia should keep the reserve in order to keep the uncertainty condition. According to data of Federal Reserve Economic Data (FRED) in 2006 until 2013, the asset reserve stable at level above 24%.

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 them on US\$2. Those numbers are known to be under the poverty rate.

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.

Based on some explanation above, the authors are interested in studying and analyzing Economic Growth, Foreign Direct Investment and Interest rate especially for Indonesia. Which is why the author gave a report entitled.

**“THE IMPACTS OF FOREIGN DIRECT INVESTMENT AND
INTEREST RATE ON INDONESIAN ECONOMIC GROWTH”**



1.2 The Main Problem

Based on the background of the study, there are several main problems that we have found in this study those as follows:

1. How the influence of Foreign Direct Investment, Interest Rate, Effective Exchange Rate and External Reserve on economic growth?
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.
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 the reader is expected to add understanding regarding the economic analysis about the impact of foreign direct investment on economic growth in the period 2000-2016.



3. For the investor is expected to provide a new discourse in considering those aspects that need to be taken into account in investment that are not solely rely on monetary measures.
4. For society will provide a proactive stimulus as a controller of economics and increase public awareness to reach stability of economic growth.
5. For government, it will be usefull as the basic in making police for the government.
6. For research, it uses this result for extend in term of economic growth, investment, interest rate, exchange rate and external reserves.

1.5 Research Hypothesis

The hypothesis of this study will be as following: FDI has positive relationship to GDP. I consider that economic growth in case in Indonesia by this following variable: FDI, Interest Rate, Effective Exchange Rate and External Reserves. 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 and EXRV.

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.

