CHAPTER I
INTRODUCTION

1.1. Background

Economic growth is a prime objective in the general framework of national economic development. One of the most widely employed indicators of the economic prosperity of a nation is the Gross Domestic Product (GDP) per capita. GDP per capita is the value arrived at by dividing the overall Gross Domestic Product of a country by the population, thereby providing the average amount of goods and services produced per capita in a particular region. Gross Domestic Product (GDP) per capita is a primary indicator for assessing the economic performance of a nation, encapsulating the general productivity and production of the economy of a country. Mireslami (2016) states that GDP per capita is utilized to quantity prosperity levels in most nations or regions.

In Indonesia, the improvement in GDP per capita is one of the government's priorities to improve the country's welfare. Mankiw (2015) argues that GDP per capita growth enhances a country's economic resilience and competitiveness. An increase in GDP per capita contributes significantly to a country's economic development, despite limitations in measuring income equality. Many aspects can affect the value of GDP per capita, such as economic growth, population, productivity levels, unemployment, etc.

The welfare of a country is one of the macroeconomic problems that is often measured using GDP per capita as its main indicator. GDP per capita is important to analyze a country development of economic because it reflects the average economic output per individual in the country which shows the economic strength of the community. Although GDP per capita is used as an variable to assess the average income in country, the classic problem that is always faced when measuring GDP per capita is that it is does not measure the income inequality that occurs in society, so even though a country in higher level GDP per capita value, not all people in the country necessarily have high incomes.

The rise in Indonesia's GDP per capita value in the last two decades indicates an increase in the economic growth of Indonesia. Based on a report from BPS, in 2000 Indonesia's GDP per capita value was only IDR 6,140,000 and in 2023 it increased to IDR 75,000,000. Although the growth seems to increase significantly, but can this growth have an impact in influencing the distribution of welfare in Indonesia. This is in line with Kuznets' theory which explains that increasing GDP per capita does not always increase economic equality, of course this depends on the economic situation of the country, including Indonesia. Based on the World Bank report, Indonesia's Gini Ratio value in 2003 was 29. In another report conducted by Oxfam (2017) it was found that the 4 richest people in Indonesia control wealth equivalent to the 100 million poorest people in Indonesia, this reflects that wealth is still concentrated in a small group of people. Therefore, a question arises "can the increase in GDP per capita encourage inclusive development, or does it actually deepen the level of inequality?".

To support the rise in GDP per capita, not all countries have sufficient capacity to fulfill this. This is where the role of investment is needed to realize every existing plan so that it can be implemented. Investment can drive economic growth through capital distribution, so that it can meet the budget needs for economic growth to be implemented. Discussion on increasing GDP per capita is not only a discussion about quantity but also quality. The quality of GDP per capita is influenced by Income Inequality and Human Development Index, low quality HDI can be a challenge for a country to support increasing GDP per capita, meanwhile, high inequality can also reduce the potential for GDP per capita growth in a country.

The discussion of GDP per capita is complex, therefore this complexity is also inseparable from the role of Foreign Direct Investment (FDI), Domestic Direct Investment (DDI), and the Human Development Index (HDI). According to (Borensztein et al., 1998), although FDI has the potential to increase productivity, it is often concentrated in capital-intensive sectors such as mining, so there is minimal absorption of labor which can increase inequality. On the other hand, according to Sjöholm (2018), Domestic Direct Investment based on MSMEs and the real sector is considered to be able to provide a more inclusive impact, but obstacles such as low access to capital and infrastructure are still a problem for DDI development. Meanwhile, the difference in Human Development Index values between regions in Indonesia shows a level of disparity that can hinder national economic productivity.

On the other hand, the Kuznets curve theory says that in the early phase of economic growth, inequality will increase and as industrialization increases, inequality will decrease. However, based on the report by the World Bank in Indonesia, there is stagnation in the level of inequality, indicating a failure of the equalization mechanism. Acemoglu & Robinson (2012) the study explained that high inequality can trigger social instability and reduce the effectiveness of growth as an effort to achieve inclusive growth.

Therefore, an analysis is needed to understand how FDI, DDI, Income Inequality, and HDI interact with GDP per capita in Indonesia.

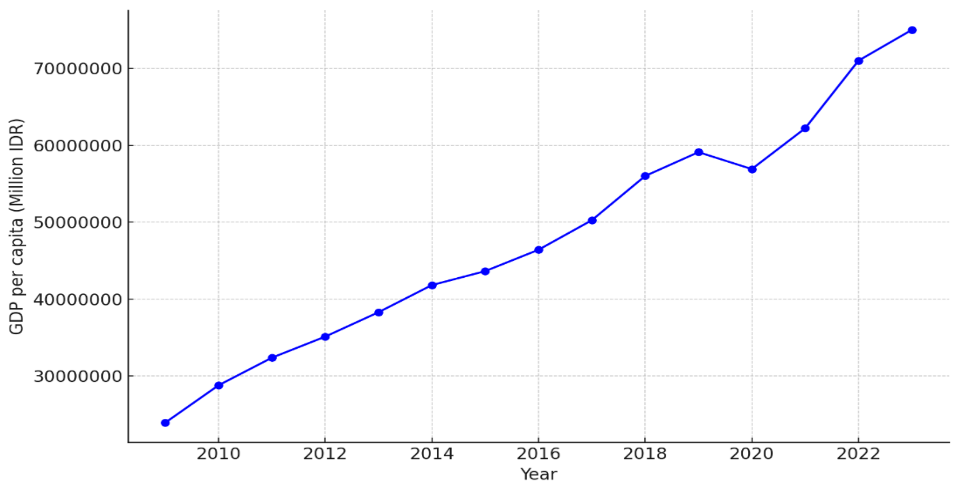

Figure 1. 1 Gross Domestic Product of Indonesia 2009 - 2023 (IDR)

Source: BPS, 2023 (data processed)

From the picture above, it can be seen that the trend of GDP per capita is increasing. Overall, there is a rise in the trend of GDP per capita from 2009 to 2023. This shows that the income or economic output per person in Indonesia tends to increase over time. For example, in 2009, GDP per capita was IDR 23.914.000, while in 2023 it increased to IDR 75.000.000. This means that the average person in Indonesia is producing more output in the economy, which could reflect improvements in economic welfare. Despite the overall increase, there are some years where GDP per capita has stagnated or even decreased, for example, in 2012, GDP per capita was IDR 35.105.000, but in 2011 it was higher at IDR 32.363.000. This could be due to various factors such as the global economic slowdown, commodity price fluctuations, or domestic economic policies that affect economic growth. In a developing country like Indonesia, variables like investment (Foreign Direct Investment and Domestic Direct Investment), and human development index, are important to affect the value of GDP per capita.

One of the main drivers of economic growth in developing countries is Foreign Direct Investment (FDI), including Indonesia. To increase productivity, introduce new technologies, and create jobs in various sectors, Foreign Direct Investment has an essential role, not only as a provider of capital but also has a role in increasing the competitiveness of local industries through improving workforce skills and knowledge transfer. In Indonesia, the increase in FDI flows in recent years, as seen from the increase in FDI realization from IDR 391.800.000 million in 2019 to IDR 775100000 million in 2023, contributes to GDP per capita growth. The increasing GDP per capita indicates an increase in average income due to increasing economic output, the flow of foreign investment to Indonesia is also thought to have a role in this. Borensztein et al. (1998) explain that a significant impact on economic growth can be exerted by Foreign Direct Investment (FDI), particularly when the host country possesses adequate levels of human capital necessary to absorb the technology introduced by foreign investors. Through FDI strategic sectors such as manufacturing, technology, and infrastructure, experience accelerates development, thereby driving increases in GDP per capita.

Furthermore, Domestic Direct Investment also plays a key role in influencing the growth of the economic, which similarly impacts the GDP per capita of Indonesia. The role of DDI is in strengthening the foundation of the domestic economy through the development of local industries and increasing domestic competitiveness. The realization of DDI investment in Indonesia has increased quite significantly, for example, in 2019 DDI was worth IDR 386,498.4 billion, then became IDR 674,923.4 billion in 2023. This improvements align with the government effort to enhance the participation of domestic enterprises in national economic development. Robust Domestic Direct Investment can increase economic output, thereby contributing to the rise in GDP per capita. Alfaro et al. (2004) contend that Domestic Direct Investment reinforces the positive impact of foreign capital inflows, particularly in promoting more inclusive growth. Therefore, to create sustainable growth of economic growth, the role of Foreign Direct Investment and Domestic Direct Investment is important, as variables that affect GDP per capita in Indonesia.

Table 1.0.1 Development of DDI and FDI Investment Realization in Indonesia in 2019-2023

Years	Foreign Direct Investment (Million Rupiah)	Domestic Direct Investment (Million Rupiah)
2019	391,786.4	386,498.4
2020	404,362.5	413,535.5
2021	443,403.4	447,063.6
2022	717,693.4	552,769
2023	775,050.9	674,923.4
Total	2,732,297.6	2,474,789.9

Source: BPS, 2023 (data processed)

From the Domestic Investment (DDI) and Foreign Investment (FDI) in Indonesia table above explain there is a consistent improvement in both types of investment. From 2019 to 2023, DDI increased from IDR 386,498.4 billion to IDR 674,923.4 billion, with total investment over five years reaching IDR 2,474,789.9 billion. This increase explains the important role of DDI in strengthening local industries. On the other hand, FDI also showed a steady increase in that period, from IDR 391,786.4 billion to IDR 775,050.9 billion, with a total investment value of IDR 2,732,297.6 billion over the period. This increase reflect Indonesia's attractiveness as a foreign investment destination, especially in many strategic sectors.

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Not only investment, the Human Development Index (HDI) can also have an impact on GDP per capita in a region. The Human Development Index (HDI) is the main indicator used to assess the quality level of a nation's human resources, which includes aspects of health, education, and standard of living. Sudarlan (2015) explains that HDI has an important role in increasing Gross Domestic Product (GDP) per capita because a more educated and healthier society tends to be more productive, which contributes directly to economic growth and potentially increases the GDP per capita. Based on BPS, the HDI in Indonesia has increased from 71.92 in 2019 to 73.74 in 2023, so there are improvements in access to education, health, and the living standard. This increase in HDI is directly proportional to the rise in GDP per capita, as a more skilled and healthier workforce can contribute more to national economic output. According to Sudarlan (2015), regions with higher HDI tend to experience faster GDP per capita growth, because investments in education and health result in increase of labor productivity and economic competitiveness. So, an increase in HDI not only reflects better social welfare but also supports sustainable GDP per capita increase in Indonesia. Even so, when looking at the United Nations Development Program (UNDP) classification standards, Indonesia placed into the medium-high HDI category.

One important factor that also influences GDP per capita is income distribution. Income distribution is a crucial factor in identifying the extent to which economic growth benefits all levels of society. Cerra et al. (2021) showed that one of the factors inhibiting GDP per capita growth is the high inequality in income distribution, because most of the population does not have equal access to economic resources such as education and health. The greater the inequality, the lower the overall productivity and the more it hinders the increase in GDP per capita. Based on BPS, Gini coefficient used to measure income inequality in Indonesia. In 2019 the gini coefficient reached 0.380 and in 2023 reached 0.388, which makes Indonesia categorized as a country with moderate income inequality. A more equal income distribution allows more individuals to contribute productively to the economy, which can increase GDP per capita. Cerra et al. (2021) also explain that reducing income inequality through appropriate redistribution policies can strengthen economic growth by expanding people's access to health services and education, which affects productivity of labor and GDP per capita. Thus, equal income distribution is not only important for social justice but also to support sustainable economic growth.

Many studies have explored the effect of variables that have been described previously on GDP per capita, but more complex studies that examine and integrate the independent variables are still limited. For example, research by Ajija (2023) shows that FDI can drive economic growth while increasing the HDI is important for sustainable development. Therefore, researchers feel that there is a gap that need to be filled through this research so that it can be useful for formulating more effective policies for policymakers in Indonesia. This research purpose is to fill this gap by analyzing the impact of Foreign Direct Investment (FDI), Domestic Direct Investment (DDI), Human Development Index (HDI), and income distribution (Gini Coefficient) on GDP per capita.

Increasing flows of Foreign Direct Investment (FDI) and Domestic Direct Investment (DDI), as well as improvements in the Human Development Index (HDI), have played an important role on affecting Indonesia's GDP per capita in recent decades. However, the challenges of unequal income distribution and unequal economic growth across regions remain major obstacles to achieving inclusive prosperity. Meanwhile, the expected increase in GDP per capita as an indicator of welfare is not always in line with equal access to education, health, and economic opportunities across provinces. Previous research shows that the synergies between investment, human capital quality, and income equality are critical to promoting sustainable and more inclusive economic growth in Indonesia. Therefore, researchers are interested in conducting a study entitled "The Impact of Foreign Direct Investment, Domestic Direct Investment, Human Development Index, and Income Distribution on GDP per Capita of Indonesia."

1.2.Problem Formulations

Based on the explanation before, several problem formulations can be concluded:

1. How does Foreign Direct Investment affect Indonesia's GDP per capita?

2. How does Domestic Direct Investment affect Indonesia's GDP per capita?

3. How does Income Distribution (Gini Coefficient) affect Indonesia's GDP per capita?

4. How does the Human Development Index affect Indonesia's GDP per capita?

1.3.Research Objectives

1. To analyze how Foreign Direct Investment (FDI) affects GDP per capita of Indonesia.

2. To analyze how Domestic Direct Investment (DDI) affects GDP per capita of Indonesia.

3. To analyze how the Income Distribution (Gini Coefficient) affects GDP per capita of Indonesia.

4. To analyze how Human Development Index (HDI) affects GDP per capita of Indonesia.

1.4. Significance of the study

1. The results of this study are expected to be useful for increasing the knowledge of researcher regarding the factors that influence GDP per capita.

2. As an application of knowledge and theories obtained during college and comparing them with the reality in the field.

3. The results of this study are expected to be useful as a reference for conducting further research.

4. This study is expected to be information for related institutions as a consideration in determining policies related to increasing GDP per capita.

5. Provide information to all parties interested in this research.