THE IMPACT ANALYSIS OF EXTERNAL DEBT AND FOREIGN DIRECT INVESTMENT ON GROSS DOMESTIC PRODUCT IN INDONESIA

THESIS

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"THE IMPACT ANALYSIS OF EXTERNAL DEBT AND FOREIGN DIRECT INVESTMENT ON GROSS DOMESTIC PRODUCT IN INDONESIA"

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ABSTRACT

As a developing country, Indonesia needs a huge fund to implement its development so as not left behind from other countries. The development process in developing countries are always faced with limited domestic savings and foreign exchange shortages that required net capital transfers from abroad either in the form of external debt and foreign direct investment. The successful development of a country can be seen from the increase in gross domestic product (GDP) as an indicator to measure a country's economic growth rate. The purpose of this study was to analyze how the influence of external debt and foreign direct investment to increase in GDP in Indonesia in the period from 2000 to 2010. The thesis analyzes the impact by using OLS (Ordinary Least Square) of time series data by using the gross domestic product (GDP) as the dependent variable and independent variable that are external debt, foreign direct investment and domestic saving. Regression results show positive and significant relationship between foreign investment and domestic saving to GDP in Indonesia, while foreign debt is also related to positive but not significant.

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PREFACE

بسم الله الرحمن الرحيم

Assalamualaikum Wr.Wb.

In the name of Allah, the Beneficent, the Merciful. Praise and Gratitude be to Allah for giving the strength, opportunity and guidance for the writer, so that this thesis can be finished accordingly. Peace and blessing be upon Prophet Muhammad SAW.

The thesis is written to fulfill one the requirement to obtain the Bachelor degree. The writer interested to research about external debt and foreign direct investment. So, the thesis entitled "The Impact Analysis of External Debt and Foreign Direct Investment on Gross Domestic Product in Indonesia. For this thesis I got data from BI and UNCTAD then some references from journal to adding my information.

The writer aware of the fact that complementing this thesis is not easy, the writer got some obstacles and difficulties in writing this thesis. The writer realizes that this thesis is far from perfect and good thesis. So that writer needs positive critics and suggestion from the readers in order to make the thesis better. Finally, writer hopes that this paper could give information about bout external debt and foreign direct investment in Indonesia and wish have benefit for readers.

Wassalamu 'alaikum wr.wb

Padang, May 2011

SILVIA SARI

MOTTO

" And ask for help (to Allah) with patience and (do) prayer."

(Qs. Al Baqarah :45)

"He who is guided by God, it was he who guided, and whoever is led astray by God, then they're the ones who are the losers". (Qs. Al Araf : 178)

"Truly Allah will not change the fate of a people until themselves are changing himself". (Qs. Ar ra'ad : 11)

"Those who believe and do pious deeds, for them Gardens of Delight".

(Qs. Luqman : 8)

"Verily after difficulty there is relief. When you have finished (from a business), do solemnly (affairs) the other, and to your Lord you expect ".

(Qs. Al Inshirah : 6-8)

"When there is a will there is a way"

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CHAPTER 1

INTRODUCTION

1.1 Background

Indonesian economic development at present shows is becoming more integrated with world economy. This is a consequence of life in the open economy systems in its activities are always associated and inseparable from the phenomenon of international relations. The openness of this economy has an impact on the development of a country's balance of payments which covers trade and traffic flows of foreign capital of a country. Economic development is a process of long-term increase in income per capita. In the development of the necessary funds either for production, infrastructure development or for maintenance development outcomes has been achieved. The sources of development financing are basically derived from domestic capital and foreign capital. Source of domestic capital is in the form of savings, both public sector savings and private sector and community. While capital from abroad is a form of foreign private investment, grants, as well as aid or foreign loans (Kustitanto and Komariah, 1999:1).

One of the problems in the implementation of economic development faced by developing countries including Indonesia is the lack of domestic capital (chenery and Strout, 1966 in Tambunan, 2008). This is reflected in the rate of savings investment gap (two-gap model) and "Foreign Exchange Gap" (*forex gap).* Saving Investment gap illustrates the gap between domestic savings to fund the investment required, while the Foreign Exchange Gap illustrates the gap

between the needs of foreign exchange to finance imports of goods or services with the revenue of the exported goods or services. Because of that developing country need foreign loans to cover the shortage of investment financing needs and to finance the current account deficit (current account) balance of payments in order to finance international transactions so that the foreign exchange reserve position is not disturbed. To cover two gaps in the required net capital transfers from abroad either in the form of foreign loans or foreign direct investment.

For a developing country, economic development is a major instrument in achieving national goals. The successful development of a country can be seen from the increase in GDP (Gross Domestic Product) which is one indicator to measure a country's economic growth rate. Theoretically, it can be said that the more advanced development of a country the greater it's GDP (both total and percapita), So that the public welfare increases with higher growth assumption in the comparative growth of population (Boediono, 1981).

It seems that the influence of the global financial crisis this time started to feel since the last quarter of 2008. This is reflected by the phenomenon of absorption is not Indonesia's export products in world markets. As a result, accelerated economic growth in Indonesia would be slowed. If not treated quickly and properly, there will be layoffs, unemployment and increased poverty. From the year 2000-2004 the Indonesian economy growth by an average 4.6 percent per year after declining -13.1 percent in 1998 due to economic crisis. For 2006, Indonesia's economic outlook was more positive. Economic growth accelerated to 5.1 percent in 2004 and reached 5.7 percent in 2005.

According to Bureau of East Asian and Pacific Affairs, 2010, Before Global financial crisis economies growth is 6.3 percent at 2007 and drops significantly to 0.6 percent at 2009. From the data available in 2009 GDP 4.5 percent with GDP per capita 2009 is 2,590.1 USD. Global economic growth started to recover since the end of 2009 will affect Indonesia to build its economic resilience to the impacts of global economic crisis. Level of sustainable economic growth and strong domestic financial markets to make Indonesia relatively immune to the global financial crisis and is a solid foundation for a stable economy and sustainable growth in 2010. After crisis GDP at 2010 raised. Its estimate for 2010 growth to 5.6 percent from 4,6 percent per year and Indonesia's central bank raised its 2011 economic growth forecast to 6 percent to 6.5 percent and it means Global economies growth is still below the number before the financial crisis.

The successful development of the increase in GDP primarily reflected the beginning of development cannot be separated from the increasing role of foreign investment. Indonesian government since the beginning of the New Order regime in 1966 has opened the door for the entry of foreign capital. The increased growth in Indonesian investment in his starts with the set laws No.1/1967 on foreign investment (FDI) and the law No 6/1968 on domestic investment. The existence of the application of the laws mentioned above, has created an investment climate conducive for investments that during the process of economic development started in Indonesia it appears logical that a lamp. It could be said that Indonesia's economic development during this period has experienced a spectacular process

of economic development at the macro level (Istikomah, 2003). Finally, the Investment Law No.25, 2007, which represents a major advancement in the effort to simplify the licensing process for these investments in order to improve the domestic investment that is expected to accommodate the desire of investors or entrepreneurs to obtain a more efficient service, easy, and fast.

Investment financing for development according to (Kuncoro, 1994) comes from four sources, namely domestic savings (saving the government and society), foreign assistance, export and foreign investment. Strout (1973) suggested that foreign funds are needed because in order to pursue a decent level of economic growth and in tune with the acceleration of population growth, the mobilization of resources from within the city alone is not enough, here's where the entry of foreign capital are conditional and selective in terms of development strategy Indonesia.

As cheated from "Analysis of Foreign Capital on Economic Growth" by the Supreme Nusantara (2001), in broad outline, there are three main sources of foreign capital in a country that adheres to an open economic system, namely external debt (debt), Foreign Direct Investment (FDI) and investment portfolio. Benefits to be expected from a package of foreign capital in the form of employment; transfer of technology, managerial training and access to international markets through exports (Pangestu, 1995). FDI is a foreign private investment made into a country. The form can be a branch of a multinational corporation, multinational subsidiaries, licensing, Joint Venture, while investment portfolio is an investment made through the capital market (Sarwedi, 2002).

Panayotou (1998) in Sarwedi (2002), this source of financing FDI by some observers, is a source of foreign financing, the most potential compared with other sources. explains that FDI is more important in ensuring continuity of developed compared with the flow of aid or portfolio capital, because the occurrence of FDI in a country will be followed by transfer of technology, know-how, management skills, business risk is relatively small and more profitable. In its annual report, UNCTAD (2001), World Investment Report, argued that the growth of FDI worldwide has increased significantly since the year 1990, 1997 and 2000, i.e. a row of 209 million USD, 437 million USD, and 1118 million USD.

Since gained independence in 1945, Indonesia has gained much experience of politics and economics. For about the first twenty years of independence, the Indonesian economy to grow less encouraging. Following the turn-turn of the cabinet which is always unstable at that time, the systems and economic policies change over time. Nationalization of foreign companies (mainly owned by the Netherlands) starting in 1951, but its implementation occurs on a large scale in 1958. This action is a continuation of the implementation of Law No. 78/1958 regarding foreign investment, which basically contains the anti-foreign investment policies. When it thrives view that foreign investment is not only an obstacle to the economic development of Indonesia, but even going to master the objective economic life.

According to Todaro (2000) Foreign debt is any capital flows into developing countries that meet two criteria i.e. the fund owner's goal to provide non-commercial loans and containing the terms of the concessional interest rates

and repayment installments to be more soft (flower should be low and the payback period is longer than any other concessional loan debt).

From 2000 the amount of Indonesian foreign debt continues to increase until the year 2010. Directorate General of Debt Management recorded a total of Indonesia's foreign debt up to marc 2010 amounted to 68.06 billion USD. That was not how, if coupled with domestic debt and state securities. Republic is supporting a debt of 1.600 trillion rupiah. Amount of fanciful. In 2003 the ratio of debt to GDP is still amounted to 62.9 percent decreased to 30.1 percent in 2008, and in March 2010 decreases to 27.0 percent.

Indonesia is currently experiencing a situation what is called Fisher's Paradox in conjunction with its external debt, namely the situation when more foreign debt repayments made the greater accumulation of foreign debt. This is due installments plus interest of external debt is substantially financed by new debt. Therefore, the value of mortgage interest plus external debt is greater than the value of new debt, and then there was what is called a net transfer of financial resources from Indonesia to the parties of foreign creditors. Fisher's Paradox situation can be demonstrated for example by comparing the cumulative value added of external debt the government sector (medium and long term). External debt problem facing the Nation in Indonesia can be spelled out in appalling conditions. Because Indonesian debt position is in the ranks of top rank in the list of world debtor nation. In running the government and organizing the development of Indonesia is still relying on external debt.

The rebuilding of the economy of European countries after World War II in the 1950's decade through a very large grants from the United States, known as the *Marshall Plan* is the most tangible evidence to prove That the importance of external debt on the economy of a state. Rana and Dowling (1988) in Nusantara (2001) suggested contribution of foreign capital flows positive on economic growth of developing countries especially in the early stages of foreign direct development. FDI contributes to either the formation, efficiency of capital investment and debt abroad to contribute more than the flow of capital.

Based on the above description, the author tries to discuss the size of GDP in Indonesia in connection with foreign debt, foreign direct investment and domestic savings by lifting the title **"The Impact Analysis of External Debt and Foreign Direct Investment on Gross Domestic Product in Indonesia".**

1.2 Research Questions

Based on the background that there is the formulation of problems that can be put forward are:

1. Does the External Debt influence the Economic Growth in Indonesia?
2. Does the Foreign Direct Investment influence the Economic Growth in Indonesia?
3. Does the Domestic Saving influence the Economic Growth in Indonesia?

1.3 Limitation of Study

The scope of the this study analysis is Gross domestic product (GDP) namely real GDP based on constant prices, External Debt (ED) in the research is government external debt and private external debt and investment in the research

is Foreign Direct Investment (FDI) only. Thus, Domestic savings (DS) obtained from the government sector and public sector. The range of secondary data usage time was 11 years (2000-2010). In this research, analyze how large the influence of External Debt (ED), Foreign Direct Investment (FDI) and domestic savings (DS) to GDP thus relationship between each independent variable to dependent variable.

1.4 Research Purpose and Advantages

1.4.1 Research Purpose

Objectives to be achieved in this study are:

1. To analyze the effect of variable External Debt, Foreign Direct Investment and Domestic savings on Gross Domestic Product in Indonesia.
2. To analyze the influence of independence variable that affect dependence variable.

1.4.2 Research Advantages

In the hope that this research was useful for:

a. Government

Government is policy makers as the picture to take more appropriate policies, especially policies related to economic growth in Indonesia.

b. Science

1. Adding insight to the study itself, as well as for other students
2. For additional information, literature, references and comparison to future research.

3. A reference material for researcher, other information in writing scientific papers similar in scope and time is different.

c. Researcher

1. To complete the final project to obtain a degree in economics at economics faculty of andalas university.
2. This research is a concrete manifestation of the application of the theories that have been in the can in college as well as a vehicle for expanding there partier of scientific exercise.

1.5 Hypothesis

Based on the background of the problem and research purposes, then the hypothesis that will test the truth of these studies are as follows:

1. It is suspected that external debt has a negative and significant impact to GDP.
2. It is guessed that FDI has positive and significant impacts to GDP.
3. It is domestic savings guess that has positive and significant to GDP

Writing Systematic

This thesis will from be divided into six chapters, which are:

CHAPTER I: INTRODUCTION.

This chapter consists of the background, research question, limitation of study, research of purpose and advantages, hypothesis, and writing systematic.

CHAPTER II: THEORETICAL FRAMEWORK AND LITERATURE RIVIEW

This chapter consists of theoretical framework and concept of external debt, foreign direct investment and domestic saving.

Beside that relationship between external debts to GDP, foreign direct investment to GDP and domestic savings to GDP then gives explanation from empirical studies in the past study.

CHAPTER III: RESEARCH METHODOLOGY.

This chapter consists of variables, data sources, methods and supporting another concept.

CHAPTER IV: AN OVERVIEW OF INDONESIAN ECONOMY.

This chapter consists by an over view of Indonesian economic growth, External Debt in Indonesia, development of foreign direct investment in Indonesia, development of domestic savings and the development of economics growth in Indonesia.

CHAPTER V: RESULT OF RESEARCH AND POLICY IMPLICATIONS

This chapter is result of empirical studies from this research, discussion and policy implication on the future research.

CHAPTER VI: CLOSING.

This chapter consists of conclusions and recommendations of the result of research. In the final section is equipped with appendices that follow support this research.

CHAPTER II

THEORETICAL FRAMEWORK AND LITERATURE REVIEW

2.1 Theoretical Frameworks

2.1.1 Economic Growth Account

2.1.1.1 Definitions of GDP

GDP is believed to be the best economic indicators in assessing a country's economic development. National income accounts have a major macro size on the condition of a country. In general, the condition of inter-country comparisons can be viewed from the national income. World Bank determine whether a country is in developed or developing country groups by grouping the size of GDP and the GDP of a country equal to the total expenditure on goods and services in the economy (Herlambang, 2001:16).

Sukirno (1994:33) defines GDP as the value of goods and services in a country which is produced by the factors of production owned by such citizens and foreigners. According to Samuelson (1992:112) GDP is the sum of total output generated within the boundary of a country tetentu within one year. GDP measures the value of goods and services in a country that in production in certain areas regardless of the nationality of a certain time period. Thus, citizens who work in other countries, their income does not include in GDP, as an illustration (foreigners) and foreign citizens who is in Indonesia but not in the product to include citizens in a foreign country (Herlambang, 2001:22).

In general, the GDP can be interpreted as the final value of goods and services produced within a country during a certain period (usually one year). The approach used to calculate GDP (Case & Fair, 2003:396) are:

1. According to the Production Approach, GDP is the sum of value added goods and services produced by different production units in the territory of a country within a specified period (usually one year).
2. According to the Income Approach, GDP represents the amount of remuneration received by the factors of production that participate in the production process in a country within a specified period (usually one year).
3. According to the Expenditure Approach, GDP is all the components of final demand: household consumption expenditure and private non profit institutions, government consumption, gross domestic fixed capital formation, stock change, net exports (net exports are exports minus imports).

The third concept of this approach will produce the same number so, the total spending will be equal to the amount of final goods and services generated and must be equal to the total income for the factors of production. GDP produced in this way is called the GDP at market prices, because in it was covered by net indirect taxes.

$$Y = C + I + G + (XM) \quad \text{..... (2.1)}$$

2.1.1.2 How to Calculate GDP

National income can be calculated based on two set prices in the market (Mankiw, 2003: 22), that:

1. GDP at Current Prices

National income at constant prices is the value of goods and services produced by a country within a certain period according to prices prevailing during the period.

2. GDP at Constant Prices

National income at constant prices is the value of goods and services produced by a country within a certain period based on prevailing prices of a certain year that is used as the basis for use beyond the rate of goods and services produced in the period/year.

GDP at constant prices can be calculated through:

$$GDP\ Riil = \frac{GDP\ nominal}{GDP\ deflator} \quad \ldots\ldots\ldots\ldots\ldots\ldots (2.2)$$

GDP deflator is used to eliminate inflation from nominal GDP to generate real GDP. GDP deflator reflects what is happening around the level of prices in the economy, in which:

$$GDP\ deflator = \frac{GDP\ nominal}{GDP\ riil} \quad \ldots\ldots\ldots\ldots\ldots\ldots (2.3)$$

2.1.1.3 Relationship between Gross Domestic Product with External debt and Foreign Direct Investment.

Output of goods and services an economy (real GDP) depends on the number of inputs, called the factors of production (capital and labor) and the ability to convert inputs into outputs is usually called the autonomous growth factor (Mankiw, 2003:42).

A production function shows a large amount of output can be produced with a certain amount of production factor inputs so the relationship of input Real GDP (Y) and Capital (K), Labor (L) and Autonomous Growth.

Mathematically it can be written:

$$Y = Af(K, L) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.4)$$

In a closed economy, the entire output sold domestically and expenditure. market is divided into three namely consumption, government and government spending. In an open economy, some of the output sold and partly exported abroad (mankiw, 2003:113). In calculating the national income identity (expenditure approach), net exports of an economy must always be equal to the difference between saving and investment. The concept of savings is not just a consumer of household savings, but also includes government and private savings.

To determine the relationship between private saving (TS) and government saving (T-G), private investment (Ip) and net exsport (NX) to the equation:

$$Sp + (TG) = Ip + Nx \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.5)$$

If *S* is the sum of private savings and government savings, then:

$$S = Ip + Nx \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.6)$$

$$S - 1 = Nx \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.7)$$

From the equation above can be explained that if Nx value 0, then the *S-I* means all funds that can be gather in the city sufficient to finance the required

investment. But if the *S-I* and the negative value of Nx is needed flow of foreign capital to cover both these shortcomings (lack of savings and foreign reserves).

In general, developing countries face constraints in the limited domestic savings and foreign exchange shortages in the construction process. Chenery and Strouct in Tambunan (2008) introduced an approach called two-gap model as the development of Harrod domar theory.

Model Harrod said the growth rate of output equal to the savings rate divided by the ICOR; two-gap model suggests that the savings in developing countries lack the investment fund is needed to improve the state economy's output and or developing countries have limitations foreign reserves to fund needs of capital goods imports. Limitations of savings and foreign reserves are inhibiting development efforts so that foreign capital is needed as a complement to the shortfall of domestic savings and will be able to increase output (Tambunan, 2008).

If foreign capital is denoted by *FC* then, mathematically can be written:

$$Q = \left(\frac{S+FC}{ICOR}\right) \quad \text{... . ...} \quad (2.8)$$

Foreign capital coming into a country and nation can be shaped government and foreign private capital can take the form of foreign capital pemanaman (FDI) and portfolio investment, foreign capital while the government can take the form of grants, loans and non konsensional konsensional the bilateral and multilateral.

investment. But if the *S-I* and the negative value of Nx is needed flow of foreign capital to cover both these shortcomings (lack of savings and foreign reserves).

In general, developing countries face constraints in the limited domestic savings and foreign exchange shortages in the construction process. Chenery and Strouct in Tambunan (2008) introduced an approach called two-gap model as the development of Harrod domar theory.

Model Harrod said the growth rate of output equal to the savings rate divided by the ICOR; two-gap model suggests that the savings in developing countries lack the investment fund is needed to improve the state economy's output and or developing countries have limitations foreign reserves to fund needs of capital goods imports. Limitations of savings and foreign reserves are inhibiting development efforts so that foreign capital is needed as a complement to the shortfall of domestic savings and will be able to increase output (Tambunan, 2008).

If foreign capital is denoted by *FC* then, mathematically can be written:

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2.1.2 Economic Growth Theories

The increase in GDP may arise through (Case and Fair, 1999: 326):

1. Increase in labor supply

Increased labor supply can generate more output. If the stock of fixed capital rose while labor, new labor tends to be less productive in comparison to the old labor.

2. Increase is in physical capital stock (Human resource)

The increase in capital stock to raise output, even if not in the accompanied increase in the labor force. Both physical capital increase workforce roductivity and provides valuable services directly. Investment in human resources is another source of economic growth.

3. Increase productivity

Increase productivity per unit of input indicates certain inputs produce more output. Input productivity can be influenced by changes in technology, other scientific progress and economic scale of production.

To explain how the role of each input (increase labor supply, capital stock and productivity) to produce the increase in output (real GDP) then use some of the growth model as follows:

2.1.2.1 Harrod Domar Theory (1956)

This theory was developed by Evsey Domar and Sir Roy F. Harrod (1956). The rationale is that at a certain level of national income (real GDP) are sufficient to absorb all workers with wage rates in a period to the next period will not longer sufficient to absorb the entire workforce. This occurs because of the additional

production capacity in the initial period and is available in the next period and therefore the need for additional funds to achieve the level of full absorption of labor in subsequent periods by calculating the relationship of capital funds (Capital stock = K) and their products (output = Y) or the capital output ratio.

From this theory at the conclusion that there is a direct economic relationship between the magnitude of capital stock (K) with output (Y). Any additional net capital stock (new investment) will result in an increase of output (Y) in accordance with the output capital ratio, which is called the capital-output ratio (COR). (Todaro, 2000:96) *K* here is the value of all capital goods any form of land, buildings, equipment and materials while Y can be measured with GDP. The higher the capital stock, the higher the output (GDP) generated. In this concept in saying that as a result of investments that have been done, the next time the capacity of capital goods in the economy will grow and that all capital goods are available in full use, aggregate demand must be increased by increasing the capacity of capital goods embodied as a result of investment in the past. Here in the view that the need for capital investment in creating economic growth or to promote economic growth in the need of new capital stock which is a net addition to capital stock.

In this case could set up a simple model of economic growth as follows:

1. There is a direct economic relationship is considered in the equation:

$$\left(\Delta Y = \frac{1}{v} = \Delta K\right) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2.9)$$

When

$v = \frac{\Delta K}{\Delta Y}$ which is called $ICOR$ ($incremental\ capital\ output\ ratio$)

This equation shows that the increase in capital stock (ΔK) will lead to increase of output (ΔY) to the effectiveness of capital factor is reflected by the parameter v. This means that if you want to increase output by 2 units with the effectiveness of the parameter v = 3, then the investment is in need is 6.

2. Capital accumulation depends on the income or output of which formulated the following equation:

$$S = sY \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.10)$$

Where S is propensity to saving

Factor in the accumulated capital through domestic savings which is a certain portion (s) and output (Y), meaning hook-eye on the investment financed by domestic savings, so that:

$$S = I = \Delta K \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.11)$$

$$sY = v\,\Delta Y \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.12)$$

So national output to be:

$$\frac{\Delta Y}{Y} = \frac{s}{v} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.13)$$

This equation shows that the higher savings rate, the higher the level of national output growth by investing in productive causes.

The assumption underlying this model:

1. Average saving same with *marginal propensity to save* (MPS)
2. COR same ICOR
3. Economic of labor force is exponent and constant
4. Comparison between labor and production (labor output ratio) will remain.
5. Coefficient s and k is constant.

2.1.2.2 Solow-Swan Theory

The theory developed by Robert Solow (1956) and Trevor swan (1956), known as the classical economic theory. According this theory the increase in output of goods and services in the Gross Domestic Product described by (GDP) can occur through increased provision of factor-factors of production (capital, labor, productivity) and the rate of technological progress. This view is based classical analysis that the economy will continue to have (full employment) and the capacity of capital equipment will remain fully in use all the time.

Further According to this theory, the capital output ratio (COR) maybe change and dynamic nature. To create a given amount of outputs can be used different capital with the help of workers whose different numbers. If more capital in used so little labor is needed on the contrary if the capital used less then more labor in used. With this flexibility of an economy have unlimited freedom in determining the combination of capital and labor that will be used to produce a given output.

Solow growth theory used production approach developed by *Charles Cobb* and *Paul Douglas*, known *as Cobb-Douglas* production function. These functions are written with the following equation:

$$Y=A_t F(K_t, L_t) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2.14)$$

Where: Y = Output

L_t = Labor

K_t = Capital Stock

A_t = Factor of Productivity

T = Time

This equation states that output in production will depend on amount of factor input in the form of capital, labor and factor productivity of existing technologies so that the output of goods and services in the mirror with a GDP can occur through increased supply of labor, capital increase, and the increase in productivity over time.

2.1.2.3 Dunning's Eclectic Paradigm Theory

One theory that analyzes the theory of FDI is Dunning using OLI approach framework. The "OLI" or "eclectic" approach to the study of foreign direct investment (FDI) was developed by John Dunning (1977). It has proved an extremely fruitful way of thinking about multinational enterprises (MNEs) and has inspired a great deal of applied work in economics and international business.

This theory describes three conditions that must be filled with a company if you want to make foreign investments, that:

1. *The ownership advantage of the firm* (O), Ownership advantages address the question of why some firms but not others go abroad, and suggest that a successful MNE has some firm-specific advantages which allow it to overcome the costs of operating in a foreign country.
2. *Location factors* (L), Location advantages focus on the question of where an MNE chooses to locate. A key issue that has attracted much attention is the distinction between "horizontal" and "vertical" FDI. Horizontal FDI occurs when a firm locates a plant abroad in order to improve its market access to foreign consumers. In its purest form, this simply replicates its domestic production facilities at a foreign location. Vertical FDI, by contrast, is not

primarily or even necessarily aimed at production for sale in the foreign market, but rather seeks to avail of lower production costs there.

3. *Internalization of transaction costs* (I), Internalization advantages influence how a Firm chooses to operate in a foreign country, trading off the savings in transactions, holdup and monitoring costs of a wholly-owned subsidiary, against the advantages of other entry modes such as exports, licensing, or joint venture.

Heterogeneous firms earnest sort these into different modes, based on their productivity, on the share of Headquarter services in the value of output, and on the differences in costs between home and foreign locations.

Table 2.1: Taxonomy of Location-Internalization Modes

	Location	
	Home	**Abroad**
Internal	Integrated National Firm	FDI
External	Outsourcing	Off shoring

Source: *World Economy FDI; the OLI Framework*

The horizontal motive for FDI reflects what Brainard (1997) has called a "proximity-concentration trade-off". Let $\pi t*$ (denote the operating profits which a potential MNE can earn from selling in a foreign maket subject to per unit trade costs t^* (which can include both tariffs and transportation costs). These operating profits are decreasing in t^* higher trade costs reduce operating profits. Constructing a local plant avoids the trade costs, leading to higher operating profits of π^*0; however, it requires an additional fixed cost f. Hence the trade cost-jumping gain,

the difference between the total profits from FDI, π^F , and those from exporting, ,π^x equals:

$$\textit{Where}\quad \gamma\,(t^*\text{-}f) = \pi^F - \pi^X = \pi * (0)\,\tilde{f}\,\pi\,(t^*) \quad \ldots\ldots\ldots\ldots\ldots(1)$$

Thus, FDI is encouraged relative to exports by proximity (lower trade costs t^*) but discouraged by the benefits of concentration (higher fixed costs *f*). Assuming for simplicity that each unit of output requires a single unit of labor, we can write the prating profits of serving the home-country market as πc, where *c* includes both factor costs and trade costs. If the firm remains a domestic firm and supplies its home market from its parent plant, where *w* is the local wage rate, it incurs no trade costs so its profits π^D will equal πw In that case, it incurs a plant specific fixed cost *f* as in the case of horizontal FDI, and earns operating profits of $\pi w^* t$, where $w*$is the host-country wage.

The relative profitability of FDI is therefore:

$$\pi^F - \pi^D = \mu(w^* t, w)\tilde{f} \quad \textit{Where}\ \mu(w^* t, w)\pi\,(w^* \tilde{t})\,\pi\,(w) \quad \ldots\ldots\ldots\ (2)$$

Where the latter are denoted by the term $\mu(w^* t, w)$. This off shoring gain depends negatively on the host-country wage $w*$and positively on the source-country wage (*w)* the vertical motive for FDI attaches great importance to comparative costs of production. In addition, the gain is decreasing in the source-country trade costs *t*, implying plausibly that trade liberalization will encourage FDI.

Four types of FDI in the OLI. The typology of FDI was developed by Jere Behrman to explain the different objectives of FDI (Suzana Stefanovic, 2008) are:

- Resource seeking FDI
- Market seeking FDI
- Efficiency seeking (global sourcing FDI)
- Strategic asset or capabilities seeking FD

2.1.3 External debt Concept

2.1.3.1 Definition of External Debt

According to Marco.A (2000) external debt is total liabilities of a country with foreign creditors, both official (public) and private. Creditors often determine all the terms of the debt contracts, which are normally subject to the jurisdiction of the foreign creditors or to international law (for multilateral credits).

In accordance with the decision together with finance minister and stateminister or chairman of Bappenas No.185/KMK.03/1995 of 1995, which in the mean by foreign debt is any state revenue in the form of foreign exchange or foreign exchange in process to rupiah, the rupiah, or in the form of goods or services obtained from foreign lenders to be paid back with specific requirements. Foreign debt is all conventional debt and government assistance in the form of money and goods that are generally intended to divertresources from countries like developing countries for development and equal distribution of income (Todaro, 2000).

2.1.3.2 Form of External Debt

Forms of overseas debt in Indonesia received include:

1. Assistance programs

This program assistance in the form devisits credit and food aid. Aids programs become state revenues are in use to cover the shortage of funds and shortage of food dollars and non-food.

2. Assistance Project

In the state budget this assistance include in development revenues, then detailed in the project questionnaire for various development activities of various projects. Financial aid project including technical assistance and help from professionals and educational costs of Indonesian workers abroad.

2.1.3.3 Type of External Debt

Type of foreign debt can be viewed from various aspects.

a. Foreign debt by its nature:

a. Soft loans are loans abroad with relatively low interest, namely a maximum of 3.5 percent with about 10-year grace period and repayment over 25 years
b. Half a soft loan is a loan in the form of a mixture and export credits, may also be grants loans with credit. Persyratan with repayment period of between 10-12 years, with a grace period of 3-4 years and about 7 percent interest.

c. Commercial loans are short term loans that are less than 5 years with a grace period of 6 months and interest is usually calculated based on current interest rates.

b. Foreign debt based on its use:

a. Export credits are loans from foreign banks abroad to the government on the condition that is not soft, for the use dalammenunjang export activities.

b. Sector loan program aims to support the balance of payments and budgetary development. The difference with the help of the program is the use of the set according to priority sectors and programs.

c. Foreign debt on time:

a. Short-term overseas loans are loans with terms of 5 years

b. Medium-term loans are loans with a term overseas 5-15 years

c. Long-term loans are loans with a term abroad over 15 years.

2.1.3.4 Motivation lending

1. Political Motivation

Political problems is already a first motivation from developing countries because of debt given to allied countries and third world countries, particularly countries that are supported by donor countries.

2. Economic Motivation

Economic arguments on behalf of foreign debt as a helper that is crucial for the development of developing countries, should not hide the fact that the benefits will flow to countries donor.pada will ultimately increase the financial burden of recipient countries in paying back loans.

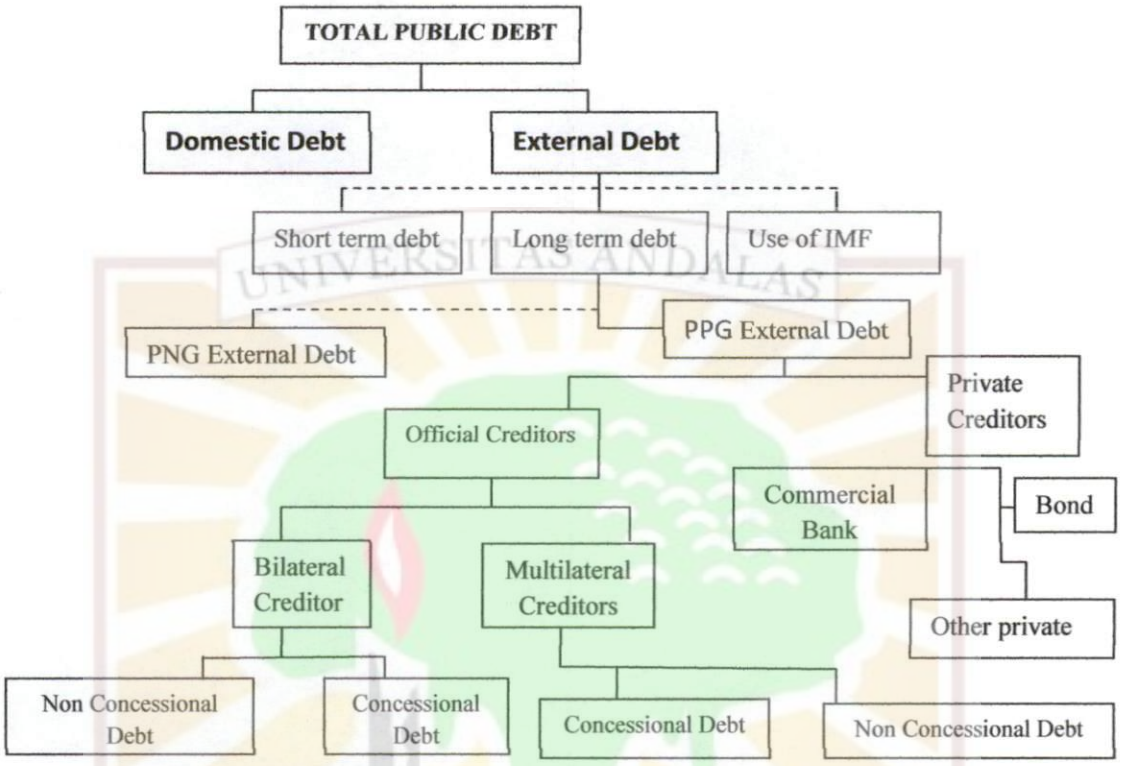
2.1.3.5 Decomposition of Total Public Debt

External debt is part of the public debt (see figure 2.1). External Debt (or Foreign Debt) is that part of the total *debt* in a country that is owed to *creditors* outside the country. The debtors can be the government, corporations or private households.

Total outstanding external_debt is defined by the World Bank as the sum of three components: *1) long-term debt, 2) short-term debt, and 3) use of IMF credit.* However, only the first component is included in the definition of public external debt, since data on short-term debt do not allow for the breakdown between public and private debt.

This decomposition is instead available for long-term debt, which is divided into: total Public and Publicly Guaranteed (PPG) and total Private Non-guaranteed (PNG) long-term debt. (PPG) consist of official creditors and private creditors. Official creditors divided to *bilateral and multilateral foreign creditors.* The differences between bilateral and multilateral foreign aid to developing countries may include differences in their correlations with the receipt countries domestic saving, in additional to the differences in their sources and motivation. Bilateral aid is mainly determined by political considerations and in some cases granted specially for develops projecs. Aid from multilateral institutions comes in most cases during period of poor economics and political condition, natural disaster, war, civil war; therefore, it's not expected to be accompanied by significant economics growth and increase savings and private creditors consist of commercial bank and bond (Munther, 2007).

Figure 2.1 Decomposition of Total Public Debt



Source: Marco Arnone and Andrea F.Presbitero (2006)

2.1.3.6 Management and Debt Payments

Foreign debt that we use has come of course at any time the recipient country must pay debt interest and principal installments of its debt in foreign currency under the terms applicable under the contract in the deal. In this connection, a country will not experience debt repayment problems if the flow of foreign capital (foreign currency) are sufficient in number to meet the payment requirement at the level needed importnya, if reversed then the debt payments difficulties arising from the country concerned.

Difficulties in repayment of debt will increase to debt crisis if the borrower country can not afford or do not want to pay; this is what caused the foreign debt crisis that eventually became the crisis of development.

Foreign debt is a cause of crisis debt which had been intended to encourage development in developing countries even eventually become a new problem in the development process and It is feared will repeat again as the economic crisis in 1997. According to Fischer (1987) from MIT (Massachusetts Institute of Technology) stated that there are three causes of external debt crises in developing countries:

1. The lack of success of macro economic control and management of the fund's foreign debt by the debtor country.
2. Failure of the lender by international commercial banks so that there 'overes limite' which resulted in breakdown of credit payments.
3. The occurrence of rising real interest rates internationally.

According to Faisal Basri (2004), external debt would have an impact on monetary policy, namely:

1. High foreign debt will lead to a persistent depresiatif pressure so that it will cause inflation.
2. Creation of a dilemma for monetary policy. On the one hand strict policy choices must be taken to curb rising inflation and falling exchange rate but the other tight monetary policy will have a negative impact on the real sector.

So in an effort to avoid difficulties in the payment of foreign debt, then the recipient countries need to manage debt properly and selectively. There are three objectives utamama in the management of foreign debt that is (a) to maintain the growth of debt is still within the limits of a country's capacity to pay, (b) to take steps in anticipation of a potential debt crisis and (c) to the implementation of recording and monitoring system decision-making for approval of new foreign debt (Kamaluddin, 1986).

Actually there is no exact formula to determine the amount of foreign debt is optimal and can bear the burden of loans that caused difficulties in payment. However, for this purpose can be done by country risk analysis related to a specific ratio analysis.

The indicator used to measure the cost of external debt burden of a country is the debt service ratio (DSR) (Hallowood,1994:368). DSR is a ratio of installment payments of principal and interest external debt to export earnings of a State. Mathematically in writing:

$$DSR = \frac{DS}{X} \quad \text{.....} \quad (2.15)$$

Where:

DSR = Debt Service Ratio

DS = Debt Service (Interest rate loan and Installment Debt)

X = Income of Export

DSR would rise if the debt ratio is growing faster than the export income, the higher the level of liquidity (the smaller the burden of external debt. In contrast, the ratio close to one means that the relevant countries will go bankrupt (lowest the level of liquidity) or fall into a debt crisis. The ratio of 20 percent means that for every one dollar exsport result, its 20 percents to pay the mortgage and interest of foreign debt). The Factors of affect the increase in DSR that; installment payments of principal and interest rate on the loan rises, the trade deficit or the level of a country's export growth to decline.

World Bank set a safe limit the amount of external debt over the following three indicators:

1. The ratio of debt payments to exports of goods and services (DSR) =20.0%
2. The ratio of total debt to export = 130-220%
3. The ratio of total debt to GDP = 50-80%

The interest rate used by commercial banks as the basis in determining interest rates loan in developing countries called the London Interbank Offered Rate (LIBOR). The loan interest rate fluctuations in developing countries often. if LIBOR increases, borrowing countries will face a payment of higher interest rates (Batis,1994:294).

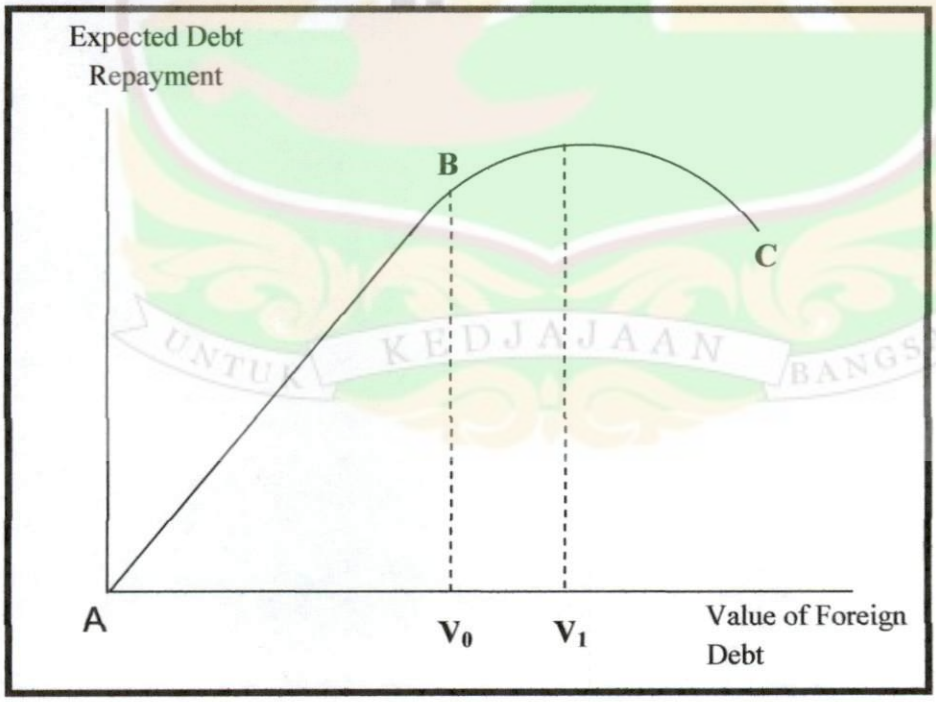
To reduce the burden of external debt, a country can make scheduling debt or debt reduction. Debt scheduling means to negotiate with the time delay in debt payments agreed on a certain date. Debt scheduling in the mean to give the debtor a period of reduction in payment obligation, as a tool to allow time for economic

recovery. Debt reduction can be done in two ways namely *debt buybacks* and *debt swaps* for like *debt-equity* and *debt-for-debt swaps.*

- Debt Laffer curve

Debt Laffer curve is a curve showing the relationship between the amount of debt payments and the size of foreign debt carried. In figure 3, point AB shows that when increasing the amount of debt that is not too large then the expected payment will also not too big. Due to the low level of debt, the bank can expect full payment from the debtor. At the level of debt above V_0 there is a positive possibility that the state will not be able to pay their debts completely. At the highest level of debt, over the V_1, increased debt obligations will reduce expected payments from the overall debt (see figure 2.1).

Figure 2.2 Debt Laffer curve



Source: *Batiz, Fransisco L. R and Luis A. R. Batiz. (1994).*

Implies a large amount of debt payment amount that will be done later also larger and take larger tax to finance it. More taxes will be decrease incentives to invest and to involve businesses more productive, and then this will reduce economic growth and reduce the country's ability to make payments later. Overall, the burden of the indebted country along the curves shown in AC, this curve is known as the Debt Laffer Curve.

- **Rescheduling of External Debt**

To cope with the increasing amount of debt, then Indonesia in collaboration with international agencies to reduce the amount owed. International coordination to help foreign debt payments, among others, the inter-governmental group (IGGI), the Consultative Group Indonesia (CGI), the International Monetary Fund (IMF), Paris Club and London Club. Paris club is an informal institution for loan creditor countries Official Development Assistance (ODA) that is provided to borrowers who have difficulty to make the loan payments out of their cities.

Financial-economic crisis that began in mid-1997 has forced Indonesia conducts its external debt rescheduling through the Paris Club I, the Paris Club II, and the Paris Club III. After the release of the Paris Club III and re-pay its debt obligations in full since January 1, 2004, earthquake and tsunami that devastated Aceh and North Sumatra back some "force" Indonesia to perform rescheduling of foreign debt due in January-December 2005.

Rescheduling dan Paris Club

Alexis Rieffel (1984) defines the rescheduling as "a form of debt Reorganization in the debtors and creditors negotiate to defer payments of a principle and or interest falling due in a specified interval for repayment on a new schedule." Rescheduling of foreign debt needs to be done by the countries that are experiencing a crisis in order to obtain "breathing space" from the burden of debt payment obligations. Historically, rescheduling through the Paris Club was first carried out by Argentina in 1956.

Paris Club is an informal forum gathering place for creditor countries under the "coordinate" a senior official in the Ministry of Finance of France. Paris Club does not have an office, do not have a secretariat, and has no founding charter (charter), in other words do not have "legal status". Through the "ad hoc institution" (even called it the Paris Club non-institution) is, countries that entwined the crisis may request waivers of debt payment obligations to the creditors. Today the forum is assisted by the French Finance Ministry staff on a part-time to arrange the smooth work. With such a format, the working mechanism of the Paris Club has a character that is quite flexible.

"Regulation" Paris Club

No such international organizations as the World Bank or IMF, Paris Club has any written rules or regulations. Paris Club operates on the basis of "rules" and "guidelines" built by a case-by-case basis and always be reviewed and

modified. Below is described as "basic guidelines" and "principles" of the Paris Club.

Basic Guidelines

There are three "basic guidelines" Paris Club, which need to be understood, namely: "participating creditors", "multilaterality", and "case-by-case principle." As an "ad hoc institution", the Paris Club has no fixed membership. Creditor countries that have a "reschedulable debts" to participate in Paris Club negotiations. Given the position of claims on developing countries is quite large, developed countries OECD members actively involved in the Paris Club Today there are 19 "permanent members" Paris Club, namely: the United States, Austria, Australia, Holland, Belgium, Denmark, Finland , United Kingdom, Ireland, Italy, Japan, Germany, Canada, Norway, France, Spain, Sweden, Switzerland, and Russia.

Principles, There are three especial principles in operation Paris Club, "imminentdefault", "conditionality"and"burden sharing"or"equal treatment".

1. The principle of "*imminent default*" implies that, in order to mereschedule debt, debtor countries must prove that without debt relief, he will fail to pay on its debt obligations (default). To measure this, the Paris Club usually refers to the projected balance of payments (Balance of Payment), the debtor in question issued by the IMF. The projection by the IMF balance of payments will greatly determine the form of concessions may be granted by the Paris Club, such as debt rescheduling only or principal plus interest.

Facilities provided by the Paris Club rescheduling is not merely to ease the burden on debtor countries, but more than that, he was given to help the debtor to regain creditworthiness (able to pay the debt obligation) to implement adjustment programs and comprehensive reform.

1. In this context, the creditors of the debtor country requires for entry into the "treatment room" IMF to implement a variety of "*conditionality*" which is supported by the IMF credit, which the IMF credit is trance for trance only be withdrawn if certain conditions ("conditionality") which contained in the "Letter of Intent" are met., which in essence will be reflected by the following formula: "limitation of money supply growth, Decrease in the government budget deficit, control of credit, improved exchange rate policy (usually removal of an over-valued rate via devaluation), lifting of price controls, and an improvement in the trade balance. Government intervention in the economy should Be Limited, and the market Should Be trusted to allocate resources According to price signals. "
2. "Burden sharing "or" *equal treatment* "implies that all creditors-both affiliated with the Paris Club and non-must share in bearing the burden of debt relief provided to debtors.

To simplify the process, the creditor countries belonging to the Paris Club would agree on "cut-off-date", the grace period ("grace period"), and the terms of repayment ("repayment period") the same.

Paris Club procedures

Reschedulingnya debt or countries to start the effort by submitting an official request to the Government of France for his arranged meeting with official creditors (official creditors). Furthermore, the debtor country, which is usually represented by the Minister of Finance orGovernor of Central Bank and the creditors, represented by officials from the Ministry of Finance, Ministry of Economy, or the Ministry of Foreign Affairs, met directly on the Paris Club renegotiations. In this meeting, the IMF, World Bank, regional development banks (such as the Asian Development Bank or the Inter-American Development Bank), and UNCTAD to participate as observers (observers).

The result of an agreement between the debtor and its creditors will be set forth in the "Agreed Minute" or MOU, which is a memorandum that provides the basis for rescheduling and implementation. Debtors and creditors of each subsequent bilateral negotiation to agree on terms and conditions of rescheduling, the results of which will be set forth in the "bilateral rescheduling agreements"

In the period 1999-2005 the government managed to reschedule external debt service payments and an end to cooperation with reducing the burden of foreign debt payments under Paris Club II meeting, 13 April 2000 were approved rescheduling of Indonesian foreign debt. While cooperation with the IMF in the framework of the implementation of rehabilitation and reform program will expire at the end of 2003. Until then the position of Indonesia to the IMF loan at the end of 2002 to 63.763 billions of dollars.

Table 2.2 IMF and World Bank's Role in the Paris Club rescheduling

IMF	World Bank
- Assist in the preparation of structural adjustment (Adjustment Programmes), including performance criteria (performance criteria) as the basis for the withdrawal of IMF loans in each tranche. - Provide a standby loan facility (the stand-by facility) or a standby loan extended (extended fund facility). - Acting as a catalyst to obtain loans from commercial banks.	-Support the debt or country stabilization programs. -Provide astructural adjustment loan program (structural adjustment lending Programmes). -To mobilize loan funds from the source/other creditors for the debt or country's development in the future. -Provide technical assistance (technical assistance) in the management of debt.

Source: Suminto, M.Sc (2006)

2.1.4 Foreign Direct Investment Concept

Investment is the company's expenditures to purchase capital goods and production tools they need to add the ability to produce goods and services available in economics. Investasi or capital formation is a second component that determines the level of aggregate expenditure (Sukirno, 2004; 121). In law No. 1, 1967 affirmed that the definition of foreign investment in this law only covers foreign direct investment made by or under the provisions of this law and who used to run the company in Indonesia, in the sense that the owners of capital blangsung bear the risk of such investments. The factors affecting these

investments include the predicted level of benefits will be obtained, interest rates, forecast future economic, technological advances, the level of national income and changes and benefits that the company obtained.

In macro-economic progress of process countries will be more fluent if the level of public savings able to balancing among the need of investment. If what happens is people saving less than it needs investment in the necessary role of the private sector overseas foreign ataw to cover the shortage. Foreign capital into the country in the form of foreign private capital and government capital. Where foreign capital in the form of FDI and portfolio investment capital while the foreign capital the government can take the form of grants, loans and non konsensional konsensional bilateral or multilateral nature. Foreign investment is one of financial resources from outside the country who can cover the shortfall in domestic savings.

According to Krugman (1991) in the sarwedi (2002) that the purpose of foreign direct investment is clear that international capital flows, FDI is where companies from one country to establish or expand their company in another State, by because it not only transfer of resources occurred, but there is also control of the company in a foreign country.

According Sarwedi (2002) Forign for investment according to the above two components, that:

1. Foreign Direct Investments (FDI) by investors who participate in corporate management to get benefits Management Company to obtain benefits from their capital invested.

2. Foreign Portfolio Investment (FPI) is an investment by an individual, company or legal entity (eg local and national pemeritah in various foreign financial instruments (eg government bonds, foreign stocks), the FPI does not involve control of the company's ownership in the foreign business entity. Investment portfolios are also actively economic links to many countries and are growing rapidly. Even in mean of dollar, investment flows portifolio, ie movement of money internationally to seek big gains in the currency markets and financial markets, far beyond the direct foreign investment.

Conceptual of difference between foreign direct investments to portfolio investment is that FDI requires kendali oleh while FPI is a passive investor does not require management effort by the investor (Henri Simamora, 2000: 421). Panayotou (1998) in the sarwedi (2002) explains that FDI is more important in ensuring the sustainability of development compared with the flow of portfolio capital or capital for the FDI sector in the State will be followed by the transfer of technology, know-how, management skills, business risk relative smaller and more profitable.

One theory to analyze the theory of FDI is Dunning (1977.1981) with "OLI framework" approach (Markusen; 1995.396) which describes three conditions that must be fulfilled if a company wanted to make foreign investment theory of ownership, location advantage and internalization advantages.

Positive contribution of FDI to national development in recipient countries according to (Todaro, 2000: 164) as follows:

1. Filling the emptiness and lack of shortage of resources between investment levels in the target with the actual amount of the Mobilize domestic savings.
2. Filling the gap between the amounts of foreign exchange is needed and hasil devisa of exports plus foreign aid is called a gap netto (or adding lacking of foreign exchange which dont in fulfilling by result of exporting and external debt. this matter is foreign exchange difference or of trade gap.
3. Filling the gap between government tax revenue target and the amount of able to collect the aktual tax.
4. Multinational companies will bring the most advanced knowledge and technology regarding the production process and introduce machinery and modern equipment to third world countries. Transfer of knowledge and technology such as this is considered very useful and productive for the country that receives it.

Positive contribution of FDI to national development of developing countries in turn affects the GDP the countries. Role of FDI potential to increase in GDP as difusser technology is also supported by the Solow growth model (1956) said the increase in technology over time will increase outpt growth (GDP) over time.

Table 2.3 Determinant of FDI

Economics Conditions	Market	Size: income level: urbanization, stability and growth prospect, acces to regional markets, distribution and demand pattern.
	Resource	Natural resource ,location
	Competitiveness	Laboravailability, cost, skill, trainability, managerial technical skill, acces to inputs, physical infrastructure, supplier base; technological support.
Host Country Analysis	Macro policies	management of crucial macro variable:ease remittance,access to foreign exchange
	Private sector	Promotion private ownership; clear and stable policies, easy entry/exit policies, efficient financial market, other support.
	Trade and Industry	Trade strategy,regional integration and acces market,ownership control,competition policies
	FDI policies	Owenership, incentive, accee to input, ease of entry, transparent and stable policies.
MNE Strategy	Risk Perception	Percepcion of country risk, base on political factors, macro management, labor markets, policy stability.
	Location, Sourcing and Integration	Company strategies onlocation, sourcing of products/inputs, integration of affiliates, strategic alliances, training, technology.

Source: Yati Kurniati and Andry.Y (2007)

2.1.5 Domestic Saving Concept

In theory the development of Keynes (1930) in Sadono Sukirno (1994) stated that the savings as part of the income of a particular period that is not exhausted in consumption in the period bersangkutan.menurut Keynes, the amount of savings made by households rather than depending on the interest rate but at large household income was small.

In Theoretical factors that affect savings is the ability and willingness to save. Saving ability is generally determined by economic factors are sepertitingkat net income per capita, where the higher income per capita, the more tinggipula ability to save S = s (Y) and per capita income distribution.

From various sources of domestic financing, domestic savings is one important factor for the financing. Domestic savings can be sourced from public or private savings, and government savings. In the context of domestic saving, ideally both components should be able to be increased synergistically and simultaneously because the savings is one indicator that can determine the economic growth of a country but in the economic development of developing countries are always constrained by limited mobilization of domestic savings, its low domestic savings lead to state develop experience of investment-savings gap (2 gap model).

The Meaning of Saving and Investment

- If government income (*T*) greatet than goverment expenditure (G), the government runs a budget surplus because it receives more money than it spends.
- The surplus of *T* - *G* represents public saving.
- If goverment expenditure (G) greatet than government income (*T*), the government runs a *budget deficit* because it spends more money than it receives in tax revenue.
- For the economy as a whole, saving must be equal to investment (*S* = *I*).

A government budget deficit represents negative public saving and, therefore, reduces national saving and the supply of loanable funds. When the government spends more than it receives in tax revenues, the short fall is called the budget deficit.The accumulation of past budget deficits is called the government debt.

2.2 LITERATURE REVIEW

Based on information obtained from many journals that relate to variables in this study, the authors found the main point in some of these journals which strengthen hypotesa theory or theories in use in research in accordance with the title of this research. Study of literature is dominated by empirical tests to see whether the effect of external debt, foreign direct investment increased national income (Real GDP) using data across country.

According to research by **Seetanah, Padachi and Durbarry (2007),** using a VAR framework for the econometric modeling for the case of the small island developing state of Mauritius over the period 1960-2004, the result from the analysis shows that external debt has been negatively associated with the output level of the economy in both short and long run. Mainly, by using OLS. Most of the earlier empirical studies include a fairly standard set of domestic, debt, policy and other exogenous explanatory variables and the majority found one or more debt variables to be significantly and negatively correlated with investment or growth. Similar with research by **Maureen (2001),** Using time series data for the period 1970-95, the empirical results indicated that external debt accumulation has a negative impact on economic growth and private investment in Kenya. Recently, Schclarek (2004) used GMM dynamic panel econometric technique to confirm the negative and a significant relationship for developing countries (but not for industrial countries).

Sritua Arif and Adi Sasono (1987: 45-46) in Agung Nusantara (2001) by using data from 1970 - 1986, found that the net flow of foreign capital into Indonesia, either in the form of foreign capital investment and foreign debt, net of debt repayments, interest and profits are transferred to overseas foreign parties, show negative cumulative value, even foreign capital is likely to affect immediate exit (crowding out) against domestic savings. Similar results were also presented by Rahman (1979), Griffin and Enos (1970), Weiskoft (1972), Chenery and Strout (1979), Hujman (1968) and Mudrajat Kuncoro (1982) which indicates that foreign investment negatively affect domestic savings in many developing countries including Indonesia. In addition, foreign capital flows can also negatively affect economic growth, although not statistically significant. These studies also found that domestic savings more important role than foreign capital, both quantitatively and statistically in determining economic growth, the study only Bangley (1978) which indicates that foreign debt to increase domestic savings, but this only happens in Latin American countries.

Ekanayake, et al analyzes of the effects of foreign aid on the economic growth of developing countries. The study uses annual data on a group of 85 developing countries covering Asia, Africa, and Latin America and the Caribbean for the period 1980-2007. In research get conclude for low-middle income countries indicating that foreign aid have a negative effect on economic growth in these countries but foreign aid significant positive on economic growth in low income countries. Thus, the findings of this study are, for the most part, consistent

with findings of previous studies on the effects of foreign aid on economic growth.

Benedict, Rina and Toan (2003), the impact analysis of External Debt, Public Investment on Growth; relatively few studies have focused on low-income countries. Used data for 55 low-income countries that are classified as eligible for the IMF's Poverty Reduction and Growth Facility (PRGF). The data cover the period 1970–99. The data cover the period 1970–99. To net out the effects of short-term fluctuations, three-year averages have been used for the panel regressions. Research the result show that high levels of debt can depress economic growth in low-income countries. In other hand, external debt has a positive impact on growth in low income countries.

Durbarry, et al (1998) in Afees Adebare.S (2007) conducted research using a model of fisher-Easterly augmented in some developing countries such as Latin America, Caribbean and sub-Saharan Africa in the period 1970-1993 by using cross section data and panel data, this study shows that external debt and other investment sources (such as domestic savings and foreign investment) has a positive impact and beneficial for the economy GDP. Durbarrry regression results indicate that foreign debt and foreign investment will have a positive impact on GDP in developing countries if economic policies are also a determinant factor in the increase of output (GDP) was in stable condition. That is, the country has low inflation, small budget deficit and the liberialisasi trade and investment and adequate external environment. in addition, regression results also indicate that the low amount of debt that can not create a faster GDP growth, but the amount of

debt that is too high will also cause low levels of GDP growth. Therefore, the optimal limit the use of foreign debt (the ratio of debt / GDP), which stimulated the growth of GDP in research is 40-45%.

Thus, research by Fayisa and EL-Kaissy (1999) also provide empirical eviden on the relationship between foreign aid and growth in developing countries drawing evidence from 77 countries between 1970 and 1990 using economics growth theories, they pointed out foreign aid, domestic saving, human capital, exports are positively correlated with economic growth in the countries studied.this finding consistent with the economics theory of foreign aid, which asserts that overseas development assistance accelerates economics growth by supplementary domestic capital formation (chenery and strout,1966). Thus, **Islam (1992)** also in his econometric study of foreign aid and economic growth in Bangladesh found that domestic resources have positive and significant impact on economic growth while foreign resources did not show any significant contribution in Bangladesh from 1972 to 1988. However, after foreign resources were decomposed into different categories, Islam found that the loans were more effective than grants and that food aid was more effective than project aid.

Similar with research by **Pattiloo, Poirson and Ricci (2002, 2004)** in Tambunan (2008), show that the impact of external debt on economics growth is very different at low levels and high levels of debt. At high levels of debt, there is a large negative impact: on average, the results imply that doubling debt from any initial debt level at or above the threshold will reduce percapita growth by about 1

percentage point at low level; the effect is generally positive but often not significant.

Nusantara, Agung and Enny Puji Astutik (2001) in his research titled "Analysis of Role of Foreign Capital on Economic Growth in Indonesia." This study aimed to analyze the contribution of foreign investment on economic growth by using the variable of foreign investment, foreign debt and domestic savings. The model used in this research is Ordinary Least Square regression (OLS). Testing cointegration in this study were calculated using Cointegration Regression Durbin Watson (CRDW) and Dickey-Fuller method. The results of cointegration tests prove that the model away from the trend regression analysis. Thus the model analysis can proceed using the model. Regression analysis showed that the foreign debt variable (ED), foreign investment (FDI) and domestic saving (S) has a significant relationship to the variables of economic growth. Coefficient estimates indicate that the variable of foreign debt and foreign investment has positive influence on the variables of economic growth, while domestic savings variable is negatively related to economic growth.

Adofu, Ilemona (2010), the study examines the impact of Foreign Direct Investment (FDI) on Economic Growth in Nigeria. Using foreign direct investment, exchange rate and total domestic savings as the explanatory variables, we examine the effect of Foreign Direct Investment (FDI) on Gross Domestic product, our proxy for economic growth and the dependent variable. Employing the OLS regression technique, our result showed that Foreign Direct Investment (FDI) has significant impact on Economic Growth in Nigeria during the period

under study. Therefore, conclude that Foreign Direct Investment (FDI) performs a role in accelerating economic growth in Nigeria. Although the relationship between FDI and economic growth was found to be statistically insignificant, but there still exist a positive relationship. Government should strive to create conducive environment for foreign direct investment in Nigeria through appropriate fiscal, monetary and general economic policies and stable political environment.

Domestic saving should be mobilized by the government through tax reduction, creation of employment opportunities and improvement of the financial system in order to increase the level of capital accumulation. Our study shows that domestic saving contributed more to the growth in GDP than foreign direct investment. In conclusion, the findings of this research are consistent with economic theory that foreign direct investments stimulate economic growth in les developed countries. Therefore, foreign direct investment plays a very important role in the growth of Nigeria economy. As long as it's inflow is encouraged, the economy will continue to witness growth in domestic product.

Borensztein, De Gregorio, and Lee (1998), analyze of the effect foreign direct investment (FDI) on economic growth in 69 developing countries over two decades. The main regression result indicate that FDI has significant positive overall effect on economics growth.their findings suggest that FDI is an important vehicle for the transfer of technology and it contributes more to growth than does domestic investment. Their findings, however, also suggest that FDI is more effective in enhancing economic growth only in countries where the level of

education (a measure of absorptive capacity) is high. Similar with research by **Jamzani Sodik & Didi Nuryadin (2005),** analyze the affect of investment on regional economic growth 26 province pre and pasca autonomy for periods of 1998-2003 using GLS method (General Least Square) for process polling data. The results of quantitative studies conducted in the 1990s found positive and significant correlation between investment in economic growth. Likewise, the results of research **Agrawal, Pradeep (2000)** find conclude that the impact of FDI inflow on GDP rate is found to be negative prior to 1980, midly positive for early eighties and strongly positive over in the late eighties and early ninties, supporting the view that FDI is more likely to be beneficial in more open economies.

Thus, research by **Sarwedi (2002)** has same result analyze of the determinants the foreign direct investment in Indonesia. The research model uses some domestic characteristics that will be combined in a short and long run period by using OLS. The Error Correction Model (ECM) and Granger Causality Test, are applied to the determine the factors that influence the foreign direct investment (FDI) in Indonesia within 1978 -2001. The result shows that economic variables such as GDP, growth, wage and export have positive effect to FDI. While non-economic variables such as Political Stability (SP) shows a negative effect. This conclusion is in a harmony with the empirical study done by Schneider and Frey (1986) that politicaal stability has a negative relations ship with FDI.

Mankiw (1992) in Rofyanto kurniawan (2003), used the Solow growth model to examine the relation between the share of investment In GDP and the stock of human capital to measure income per capita of 121 countries between 1960-1985. The model employed two inputs, capital and labor. He divided the countries into two categories: the first regression includes all 121 countries and the second case excludes oil producers. The reasons for this are that investments in the oil sector only extract natural resources, which are not a value added production and have only limited economy-wide effects. The coefficient of investment is positive and highly significant. The accumulation of physical capital showed a larger impact on income per capita than the Solow model predicted. And research by **Balasubramanyam, Salisu, and Sapsford (1996)** performed a cross-section analysis to evaluate the performance of FDI in 46 countries over the period of 1970 to 1985. They utilized population growth, the share domestic investment in GDP, the share of FDI in GDP, and export growth as independent variables in economic growth. The estimated coefficients of FDI, population, and export are positive and significant.

Bhandari, Rabindra et al (2007), the model includes the labor force, capital stock, foreign aid and foreign direct investment, and is estimated using pooled annual time series data from 1993 to 2002 in European countries. Before carrying out the estimation, the time series properties of the data are diagnosed and an error-correction model is developed and estimated using a fixed-effects estimator. The results indicate that an increase in the stock of domestic capital and inflow of foreign direct investment are significant factors that positively affect

economic growth in these countries. Foreign aid did not seem to have any significant effect on real GDP.

P.P.A Wasantha Athukorala (2003) the relationship between FDI and GDP using time series data from the Sri Lanka economy. The model is estimated using annual data for the period 1959- 2002. Data on gross domestic product (GDP), Domestic investment (DIN) export and import are obtained from the Central Bank Annual Reports In Sri Lanka FDI has increased dramatically since the 1980s. Many studies find a positive link between FDI and growth. Currently Sri Lanka provides an attractive investment regime but the response from the investor has not been very encouraging. If the ultimate objective of the government is to attract FDI for development, poverty reduction and growth, then an appropriate policy mix is necessary to achieve these.

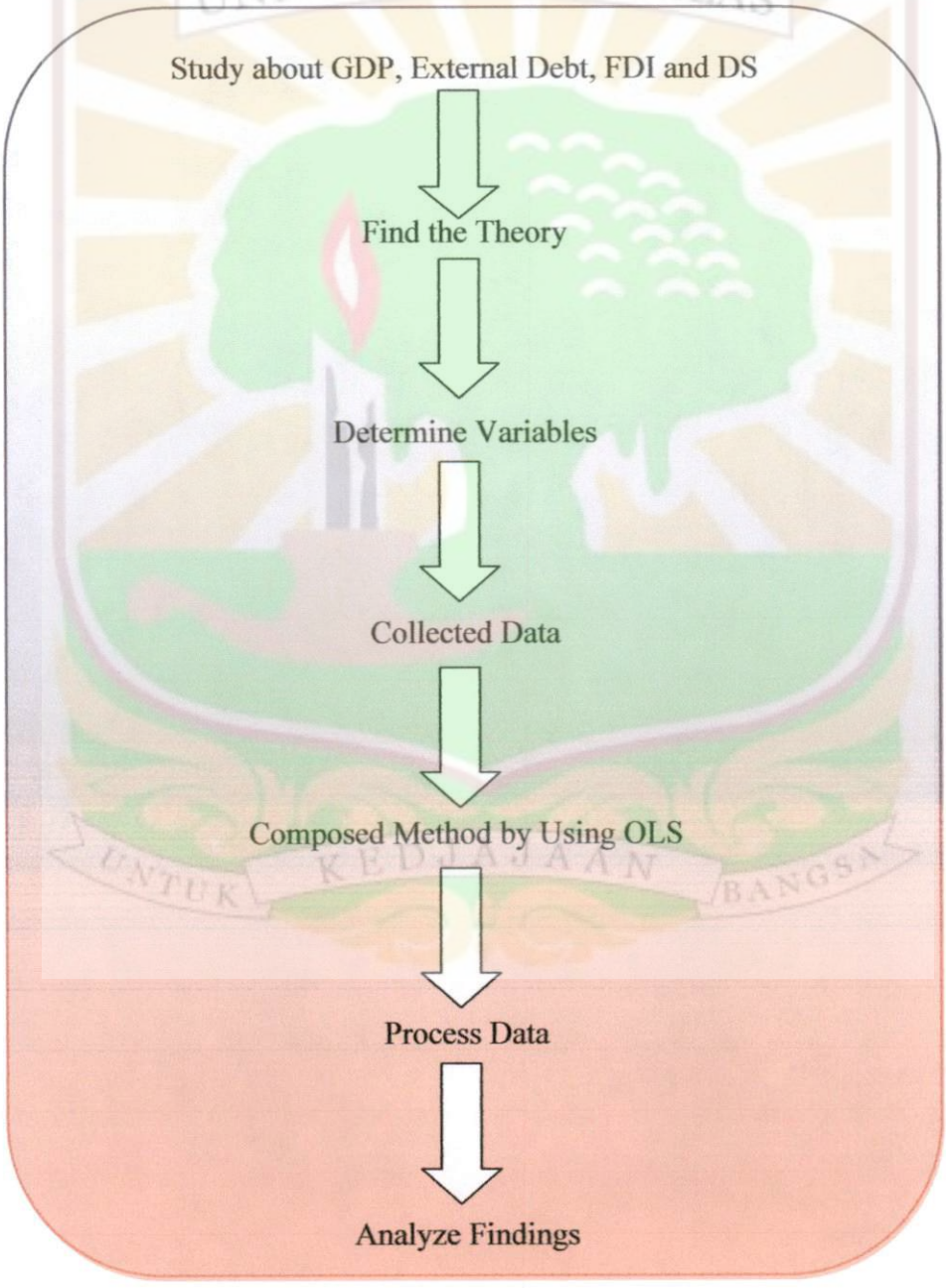
Majagaiya Kundan.P (2010) to find out the linkage between Foreign Direct Investment (FDI) and economic growth in terms of Gross Domestic Product Growth Rate (GDPGR) for Nepal over the period 1980-2006 used time series data in 27 pairs of observations. In this study, two methods are used. The statistical methods used are; the Ordinary Least Squares Method (OLS) and the Granger causality test. Before using the Granger causality test we performed some of the other test like unit root test and co-integration test. The results show that there exit a long term relationship between the variable and direction of causality runs from FDI to GDPGR. The empirical analysis on basis of ordinary Least Square Method suggests that there is weak positive relationship between the

variables and the Granger Causality Test shows that casual effect ceases and causality runs from FDI to GDP.

2.3 Framework of Research

Figure 2.3 is presented in the framework of throught in preparing this study.

Figure 2.3 Framework of Research



Source: Nurul Ilmi, (2010).

CHAPTER III

RESEARCH METHODOLOGY

This chapter will provide more explanation about the methodology that will use for this research. Also variable measurement and data sources.

3.1 Variables

I take just analysis in Indonesia case but I have some guidance from some literature review which was analyzed about this before. It also type of descriptive analysis. There are several reasons why I choose Indonesia because the external debt problem of developing country debt in particular became one of the hot topics on talk from 1980s. Almost all the economic journals, especially international economic journals, economic development and monetary policies issued by different countries contain more than one article about debt problems in the decade this.

As a developing country that is building, Indonesia needs substantial funds to finance development. In addition to efforts to mobilize funds from domestic, overseas investment funds from outside the government loans also continued effort. In an effort to attract foreign investors to invest in Indonesia, History records that in the early stages of development, countries that now are considered advanced even utilize foreign funds. In the 17th and 18th century England to borrow capital from the Netherlands, while in the 19th century the United States to borrow capital from mainland Europe, as well as in other western nations, and Indonesia is one of the developing countries that use external debt and FDI as a source of development financing.

To better focus its research and avoid mistakes of interpretation it is necessary to know the concepts and definitions of terms in use are:

1. Gross domestic product (GDP) is; a value which provides change in the production of goods and service at certain time, the country's economic growth can calculated GDP on constant price. The GDP data in billions USD.
2. External debt (ED) is; all loans that caused the obligation to pay back to foreign parties in both foreign currency and in the rupiah. All loans that caused the obligation to pay back to foreign parties in both foreign currency and in the rupiah. That in the mean External debt is overseas funds from the government sector and private sector. The External debt data in billions USD.
3. Investment is; induced in the capital into the country. There are two, namely the investment of capital investment in the country (domestic) and foreign direct investment (FDI), but in this research variable in the study only of FDI. The FDI data in million USD.
4. Domestic Saving (DS) was obtained from the government sector and public sector. Government savings is the savings that the purpose of government in the state budget, which represents the difference between domestic revenues with expenditures. Savings of society an accumulation of Tabanas, Taska, and Time Deposits. To demonstrate the value of Domestic Saving in billions USD, the Domestic Saving data previously on the fox into the form (million Rupiah) thus change into billions USD used USD Against the Rupiah Exchange Rate in period of the research studied (see appendix 3).

To simplify the bound variable (dependent) of Gross Domestic Product (GDP) and independent variable are External Debt (ED), Foreign Direct Investment (FDI) and Domestic Saving (DS).

3.2 Data Sources

The Data Used in the analysis is secondary data time series 11 year (period of 2000 to 2010) obtained from:

1. World Economic Outlook, International Monetary Fund (IMF)
2. Asian Development Bank (ADB data base; key indicators of developing and Asian and Pacific countries).
3. Statistics of Economics and Financial Indonesia, BI (Various Editions)
4. BI Annual Reports (Various Editions)
5. Books, thesis, Internet and Journals

3.3 Method of Analysis

3.3.1 Descriptive Analysis Method

Based on the research objectives and hypothesis testing that has been put forward, the model will be used descriptive analysis, regression analysis of research model approach to statistical methods, and linearity test Descriptive Analysis. Presentation of data concerning the development of economic growth using the gross domestic product data on constant price, because this data is an indicator of economic growth. Method used in this analysis is to describe the factors associated with problems in purpose as supporting the results of the quantitative methods of analysis.

3.3.2 Analysis Method Multiple Linear Regression

Method Used to Analyze the data in this study is the ordinary method lest square (OLS), using the program E-views 6.0 that is a computer software application programs statistics for version see the influence of independent variables on the dependent variable then the linear regression equation regression Used. Regression aims to see the influence of one variable with a variable that is influenced the other. In multiple regressions variable independently more than one seta has one dependent variable (Nugraho, 2005).

As cheated from "Analysis of Foreign Capital On Economic Growth" by Agung Nusantara (2001), the basic model used in this research is the economic growth model that was developed by Papanek (1973) and Mosley So, the model to this analysis is:

$$GDP = f(ED, FDI, DS) \quad \ldots\ldots\ldots\ldots\ldots\ldots \quad (2.16)$$

Where:

GDP = Gross Domestic Product

FDI = Foreign Direct Investment

ED = External debt

DS = Domestic saving

To simplify the equation above the equation transformed into the semi-logarithmic for purpose to obtain the elasticity so that these equations can be

written in the form (Gujarati, 1997). With linear model then get the model as follows:

$$GDP = \beta_0 + \beta_1 ED + \beta_2 FDI + \beta_3 DS + \varepsilon \quad \ldots\ldots\ldots\ldots\ldots\ldots (2.17)$$

Based on the model, then the above equation is transformed into a logarithmic equation and used as an analysis, namely:

$$LOG\ GDP = \beta_0 + \beta_1\ LOG\ ED + \beta_2\ LOG\ FDI + \beta_3\ LOG\ DS + \varepsilon \ldots\ldots (2.18)$$

When:

β_0 = Constanta

β_1 = Coefficient that indicates the amount of change in GDP that occurred due to the influence of External Debt.

β_2 = Coefficient that indicates the amount of change in GDP resulting from the influence of Foreign Direct Investment.

β_3 = Coefficient that indicates the amount of change in GDP resulting from the influence of Domestic Saving.

GDP = Growth Domestic Product

FDI = Foreign Direct Investment

ED = External debt

DS = Domestic Saving

ε = Error (disturbance term)

Regression equation should be BLUE (Best Linear Unbiased Estimated) means the decision-making through the F test and T test should not be biased. To generate BLUE decision, it must meet four basic assumptions that should not be violated by multiple linear regressions (Almilia and Utomo, 2006), namely:

1. There should be no autocorrelation;
2. There shall be no heteroscedasticity;
3. There shall be no multicollinearity
4. Data are normally distributed.

3.3.3 Test Statistical

Statistical testing methods

Hypothesis that has been formulated will be tested by using the method of approach to the level of confidence (level of significant), (J.Supranto, 1983).

Step of testing Hypothesis

H0 = 0 : No effect of independent variables with the dependent variable.

H0 # 0 : There is any effect of independent variables with the dependent variable.

H0 > 0 : Independent variable positive correlated with the dependent variable.

H0 < 0 : Independent variable negative correlated with the dependent variable

Various Tests

3.3.3.1 Econometric Testing

The test results of regression using econometric analysis through T-test, F-test and coefficient of determination (R^2).

1. T-test

T test aims to determine how much influence each individual independent variable (partial) to the dependent variable. If the T-test is greater than the T-table, its mean ßi statistically significant.

$$T_{test}=\frac{\beta_i}{Se\beta_i} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (1)$$

Where:

T_{test} = value that is calculated

β_i = Regression Coefficient

Se = Standard Error

Provisions areas follow:

- $H_0 : \beta_i$ = Independent variable does not affect the dependent variable.
- H_a: β_i = Independent variable affect the dependent variable.

2. F-Test

F test used to test the overall independent variables at once to the dependent variable. When the F-test value obtained is greater than F-table means that overall independent variables tested are dependent explanatory variables.

$$F - test = \frac{R^2(K-1)}{(1-R^2)(N-K)} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2)$$

Where:

F: Value is calculated

R: Coefficient Determination

K: Independent Variables

N: Number of Observations

Provisions are as follows:

- If the F test > F table then H_0 rejected and H_a accepted.
- If the F test < F table then H_0 is accepted and H_a is on the decline.

If the calculated F value of F table means there is a strong relationship between the free variable with variables bound as a whole and have a significant influence on the dependent variable.

3. R^2-Test

The coefficient of determination (R^2) aims to find out how much the ability of independent variables in explaining the dependent variable. R^2 values ranged from 0-1. The higher value of R^2, the greater the percentage of dependent variables which can be explained by the independent variables in the period of research. Value to see the correlation is:

$$R = \sqrt{R}^2$$

While coefficient determination used to determine the influence of independent variables on the dependent variable, the value of R^2 can be searched using the following formula:

$$R^2 = \frac{b_1 \Sigma x1Y + b_2 \Sigma x2Y}{\Sigma Y^2} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots (3)$$

Where:

$$0 \leq R \leq 1$$

Following provisions:

- $R^2 = 0$ is close to 0, meaning relations between the two variables is very weak.
- $R^2 = +1$ or close to 1, meaning relations between the two variables is positive or very strong.

3.3.3.2 Clasic Testing

1. Multicollinearity Test

Test the correlation between independent variables Multicollinearity has the meaning of a perfect linear relationship or the imperfect among the independent variables in linear multiple regression for detect whether or not multicollinearity in a regression model, one method used is by looking at the coefficient correlation (r) between independent variables. If the value of the correlation coefficient between each independent variable is less than 0.85 then the model can be declared free of the classical assumption Multicollinearity. If more than 0.85 then it is assumed there is a very strong correlation between independent variables causing multicollinearity.

2. Heteroscedasticity Test

Heteroscedasticity test whether the regression model has a correlation between the free variable. Methods to detect the presence or absence of heteroscedasticity problem can be done formally or informal way, which is used to examine the problem of heteroscedasticity, can use the method of White heteroscedasticity no cross term. If the probability value of chi squares on white test without cross terms is larger than $\alpha = 5\%$, it can be say that the model regression equation is not affected by heteroscedasticity.

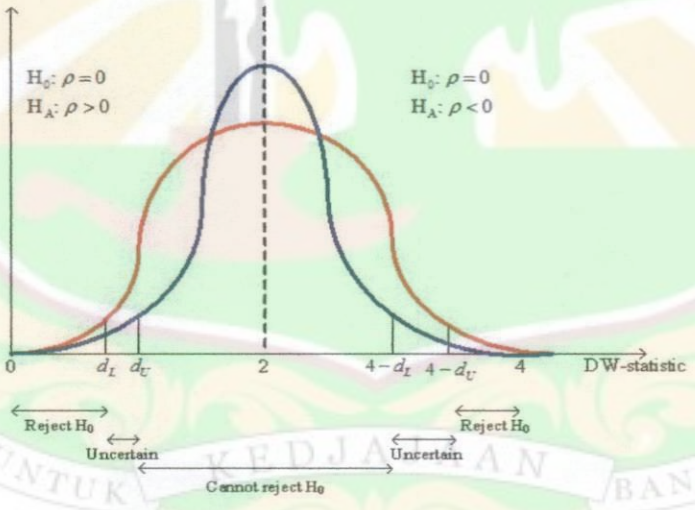
3. Autocorrelation Test

Autocorrelation means that the correlation between members of one observation with another observation that differentiated time. If there is a correlation there is a problem Autocorrelation. In connection with the assumption

of ordinary least square method (OLS). Autocorrelation is a correlation between a variable disorder with a variable other disorders, while one of the important assumptions associated with OLS method is not variable disruption of the relationship between the variable interference with each other disturbance variables (widarjo, 2005). In cross section data rarely meet the elements of time series data Autocorrelation. In often autocorrelation problem arises because the time series data often showed the same trend is an upward movement of the similarities Autocorrelation.

Presence or absence can be used *Durbin-Watson (DW)* test following:

Figure 3.1 Durbin-Watson Tests



Durbin-Watson test statistic indicates that:

$0 < d < dL$: Reject the Null Hypothesis, there is Positive Autocorrelation.

$dL \leq d \leq dU$: Regional Doubt, No Decision.

$dU \leq d < 4\text{-}dU$: Accept Null Hypothesis, there is No Positive or Negative Autocorrelation.

4-dU ≤ d ≤ 4-dL : Areas of Doubt, No Decision

4-dL ≤ d ≤ 4 : Reject the null hypothesis, there is a Negative Autocorrelation.

In addition to using the Durbin-Watson, autocorrelation test can also be done with the method Breusch-Godfrey more in the know with (*lag)* multiplier test (LM). Not a problem autocorrelation can be seen from the Chi Square probability value (greater than α = 5%).

One way to eliminate the influence regression autocorrelation is to include lagged dependent variable into the regression model, for example regression models:

$$Y = \beta_0 + \beta_1 X1 + \beta_2 X2 + \beta_3 X3 + \beta_4 X + e$$

Believe that there is autocorrelation in, to eliminate the influence of the model regression autocorrelation done by inserting lag dependent variable (GDP) into the model so that the regression model becomes:

$$Y = \beta_0 + \beta_1 X1 + \beta_2 X2 + \beta_3 X3 + \beta_4 X + b_5 Y_{(t-1)} + e$$ (Gujarati, 2003)

4. Normality Test

Normality test used to determine whether the residuals of the examined had a normal distribution or not. In this research can be seen by looking at the value of skewness (near zero) or comparing the value of J-B count = χ^2 same with χ^2 value table with the following conditions:

- If the value of J-B count (χ^2 count) > χ^2 value table, then the residuals are not normally distributed.
- If the value of J-B count (χ^2 count) < χ^2 value table, then the residual normal distribution.

CHAPTER IV

AN OVERVIEW OF INDONESIAN ECONOMY

This chapter discusses the overview of Indonesian economy period of 2000 until 2010 and discussed the data and the development of the variables used in the study during the study period of 2000 until 2010. This study uses Gross Domestic Product (GDP) as dependent variable and External debt (ED), Foreign Direct Investment (FDI) and Domestic Saving (DS) as independent variable.

4.1 Indonesian Economic Growth

Economic growth is one important indicator in measuring the success of economic development policies by a country. Economic growth has significance for economic actors in their policy they would do, especially in terms of their investments to invest. One indicator to determine the level of economic growth is GDP. This is because GDP is the value added generated by all economic activities including the value of products produced in a country at a certain period (usually within one year), (Sukirno,1999:19). According to Simon Kuznet, economic growth is a long term increase in the ability of a State to provide more kinds of economic goods to its population, this capability in accordance with technological progress and institutional and ideological adjustments necessary (Jhingan, 1996:72).

Economic Growth Rate is the rate of growth of output generated in the economy. To see this economic growth known as gross domestic product (GDP) with constant price. This concept is known as real GDP.GDP at current prices is Count down with nominal GDP. Nominal GDP can not be used to see economic

growth as GDP Nominal incorporating elements of price (inflation) so it does not reflect the real output produced.

The development of Indonesian national income tends to increase year to year (see table 4.1), but the growth during a certain period of experience described by the fluctuations in GDP growth over the price of constant 2000 (see figure 4.1)

Table 4.1 Indonesian GDP in the constant price (in billions USD)

Years	GDP
2000	150,19
2001	141,25
2002	172,97
2003	208,31
2004	256,00
2005	284,07
2006	364,23
2007	420,00
2008	471,26
2009	540,27
2010	670,42

Source: International Monetary Fund

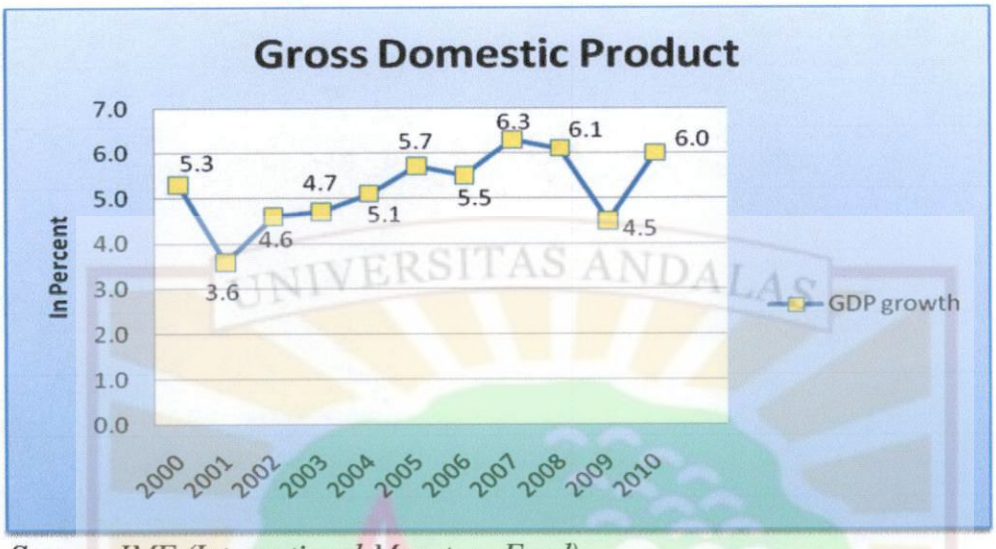
Entering the year 2000, the Indonesian economy was characterized by optimism that is high enough, during 2000 the Indonesian economy showed a strong economic recovery with a pattern of more balanced economic growth, the mark with the strengthening of the rupiah in line with declining inflation and interest rates on the real sector. Economic growth in Indonesia in 2000 amounted to 4.7 percent by value of GDP of 150.19 billion USD higher than initial estimates of BI by 3.0 percent to 4.0 percent (annual report BI, 2000), but In 2001 was the

lowest economic growth during the year 2000-2010, the GDP growth just 3,6 percent.

In addition due to poor global economy, slowing economic growth can not be separated from issues of debt restructuring and corporate sector, not the completion of internal consolidation and the relatively limited fiscal stimulus for economic growth. These developments led to the trust according to the business world to make production and investment activities, which in turn inhibits further economic expansion.

In period from 2002 to 2005 economic growth continues to increase along with improvement in macro-monetary indicators such as exchange rates, inflation and interest rates then the economy in general is still identifying the process of economic recovery. Economic growth in 2002 despite only able mencapai 4,6 percent by value of GDP of 172.97 billion USD, but in 2003 inrease to 4.7 percent with the value of GDP amounted to 208.31 billion USD and even in 2004 and 2005 getting up from 5.1 percent to 5.7 percent with the value of GDP of 256.00 billion USD and 284.07 billion USD. In both years showed the value of encouraging growth for the year because growth was above 5 percent. The increase was due to the Indonesian economy grew by improving the pattern of expansion, marked by the difficulty of total consumption which has been dominant and the increasing investment and exports, while imports decreased with increasing domestic economic activity and economic growth (see figure 4.1).

Figure 4.1 Indonesian GDP Growths



Source: IMF (International Monetary Fund)

The Indonesian economy in 2007 recorded an encouraging achievement despite pressure from the external side. For the first time since the crisis of economic growth above the rate of 6 percent, while the highest achievement during the year 2000 until 2010 with the GDP amounted to 420.00 billion USD with the stability of a well maintained, Indonesian balance of payments reached a surplus, rising foreign exchange reserves, stronger exchange rate, inflation according to the specified target. In 2009 economic growth down sharply from the previous year to 4.5 percent with the value of GDP is 540.27 billion USD because the impact financial crisis in amerika. At the end of 2010 increasing economic growth.

4.2 Indonesian External Debt

4.2.1 History and Background of Indonesian External Debt

The presence of differences in the world economy, where there is a group of developed and developing countries leading to a large difference in levels of

prosperity. Because it is of mutual interest for mutually beneficial economic relations, then the developed countries help developing countries improve their living standards. Developed countries in helping developing countries are to channel aid through an agency for co-ordinated and to achieve goals in intent, for it was founded in 1961 the OECD (Organization of Economics Cooperation and Development) based in paris. One of the commission is the DAC (Development Assistance Committee) tasked to formulate the guidelines for granting loans abroad to developing countries.

Foreign debt problem is not a new problem for Indonesia. Although this problem just seemed to be a serious problem since the (negative net transfers) in fiscal year 1984/1985, the foreign debt problem has been present in Indonesia since the first years after independence.

Commitment to develop national economy yangberbeda of colonial economy was revealed in the strong hastrat the founding father of the nation to increase community participation in the mastery of production factors in the homeland, so when viewed from the point of foreign debt, this attitude tends to Soekarno-Hatta ambiguous , namely on the one hand, foreign debt is a source of financing is the need to accelerate the process of improving the welfare of the people, while on the other side of cautious use of foreign debt as a means mencedrai Indonesian sovereignty, because donors tend to give a burdensome requirement in lending. Soekarno-Hatta cautious attitude towards the impact of foreign debt that was correct, there are three important events which prove that the

foreign debt tends to be made in state-of-state lenders as a means of injuring the sovereignty of our country.

First Even , the U.S gave loans to Indonesia amounted to 100 million USD in 1950, then American pressure on Indonesia to recognize the sovereignty of Bao Dai government in Vietnam, because the claims were not filled by Indonesia, the loan is at the end of delayed disbursements by the United States (Weinstein 1972: 210).

The second, event occurred in 1952, after declaring earnest commitments to lend; Americans make demands on the UN embargo on shipments of strategic raw materials such as rubber je china. As a UN member rubber producing countries, demand that Indonesia had to be fulfilled.

The most dramatic event occurred in 1964, following the British involvement in the confrontation with Malaysia, the Indonesian government responded by nationalizing the companies English. Knowing this, America could not help himself, having previously tried to pressure Indonesia to link the disbursement of the loan with the implementation of the stability of the IMF program, the U.S. and then linking with the next loan disbursement for Indonesia tututan immediately end the confrontation with Malaysia.

American intervention is, in the midst of widespread demonstrations against the IMF stabilization program in the country, responded to Sukarno with the slogan 'go to hell with your aid', as the phrase principled refusal to reject the foreign debt and Sukarno refused to cooperate with the imperialist or colonialist

state and prefer self-sufficient. The peak in 1965 Sukarno decided to nationalize some American companies operating in America.

Stiff resistance turned out to be in pay expensive by Sukarno. Following the mounting crisis in the national politics of eco-190-an event that is marked by the killing six generals on 30 September 1965, exact date 11maret 1965soekarno systematically under pressure to hand over to the soeharto.peristiwa kekuassan it marked the end of Sukarno and Suharto as the new ruler rise Indonesia. When his rule ended in 1966, Sukarno's foreign debt just passed 2.5 Millions USD.

When soeharto managed to replace *Sukarno,* the financial institutions and organizations of the world capitalist like the IMF, World Bank, CGI (IGGI), London Club, Paris Club, ADB, and USAID to easily enter Indonesia by dictating the policies for submission and to implement agendas in their interests (as reported by John Pilgers). When the Suharto government is willing to accept debt at the same time the Government of Soeharto's cabinet team met representatives of state and foreign companies in Switzerland to sell out the sources of our natural wealth of the Mountain of Gold and Copper in Papua, oil throughout the archipelago, bauxite, tin, forest. Based on research (the late) Prof. Soemitro (economic Begawan), during Suharto's government debt increased by sweeping with a leakage of funds up to 30 percent of each debt. Each year the budget deficit of tens of percent, but the Suharto government said a balanced budget by including the debt as a source of state revenue.

As a result, the economic crisis hit Indonesia in 1997-1998. Debt that has piled up during the New Order government has exploded. Foreign exchange reserves plummeted, the value of the rupiah plummeted, inflation soared above 50 percent, and there was reform. During That time, Indonesia entered into a group of poor countries in the world with the burden of external debt equivalent to the poorest countries on the African continent Such as Congo, Angola, Nicaragua, and Zambia.

At the end of the Suharto government to leave the debt by 54 Miilion USD, total debt increased dramatically from the Soekarno era, this is caused because the government also took over the private debt and experience a new order for 32 years showed that 30 percent of the debt is not used for productive purposes, but it was corrupted by the new order officials and cronies.

And fortunately in the Habibie government, Habibie was Able to stabilize and gradually restore the economic situation Within 512 days. But since the fall of new orders, each year tens of trillions of state budget forced to pay the debt Suharto era. In end of President Habibie's government debt reached 74 Miilion USD. In era of Gus Dur's leadership, the deficit and debt must be suppressed because it consolidates the budget because when the debt ratio has reached 80% of GDP and one of the main points Pls the Megawati administration is "wrong" to sell its strategic stocks like Indosat, Telkom, and Bank-Bank WHO have recap Bonds (Debt). At the end of the era, leaving a debt megawati is 76 miilion USD. (International Monetary Fund data).

The beginning of his reign, President *Susilo Bambang Yudhoyono-Jusuf Kalla* has warned various parties to address the problem to reduce the burden of foreign debt with the right. Another policy is to rely only on debt reduction debt exchange mechanism with the program of activities (debt swap). In 2004, the government must allocate at 9.032 billion USD for principal and interest repayments of foreign debt. In 2006, the Indonesian government's debt repayment to the IMF. The settlement amounted to 3.181.742 billions USD is the remainder of the loan should mature at the end of 2010. There are three reasons stated above such debt payments, is the increasing interest rate IMF loans since the third quarter of 2005 from 4.3 percent to 4.5 percent; the ability of Bank Indonesia (BI) to pay the mortgage debt to the IMF, and the problem of foreign exchange reserves and our ability (Indonesia) to create resistance.

Tragically again, the fact findings of the Supreme Audit Board (BPK) said that the effectiveness of the national debt just reached 44 percent of it, wonder if the state budget for education, health and protection of social security number is very small. Even subsidies for basic commodities were subsidized for BBM in eliminating. For example, just happen because of pressure from donor countries to give priority to debt repayment schedule of the spending on public welfare wonder if the ratio of the number of poor people in an era of increasing SBY . Which is characterized by worsening of the quality of life of people in various sectors such as education, health and social security protection for the people. Similarly, in any sector workers, welfare is not getting better but instead got worse.

Observing the impact of foreign debt trap Indonesia, Southeast Asia, and other poor countries, it seems clear that the acute occurrence of global injustice. The dependence of Indonesia and other poor countries of the foreign debt were eventually used as a tool by the regime of global capitalism to impose trade liberalization and economic agenda. Nothing wrong with the Vice President M. Jusuf Kalla, Indonesia decided to pay the debt to the IMF amounting to 7 billion USD for this nation is no longer controlled by the IMF and World Bank.

4.2.2 The Role of External Debt

External debt is very important to cover the gaps that occur in developing countries both from the limitations and the scarcity of savings devisa. In generally developing country has excess productive resources (especially labor) and all foreign exchange earnings which have been in use for such impor. with additional resources domestic investment projects will enable they execute newly. Available financial resources including external debt to import various capital goods and production technologies are in need, in the end the development work will go faster and this will increase the output. (Todaro, 2000 ; 183)

Foreign debt to simplify and accelerate the development process, because the foreign debt can instantly increase the supply of domestic savings (investment capital which is also a key word for the continuity of development efforts). Without external debt of developing countries concerned will have to wait many years until the growth rate economy is high enough to allow domestic savings to accumulate, In the end the expected demand for assistance will simply decline

konsensional by itself, Namely after domestic resources already cuku sufficient to support a process of sustainable development.

Foreign debt policy has been on the run the government of Indonesia since the transitional government 1969. Then the old order to new order of government, followed by worsening economic conditions in Indonesia that is the scarcity of food, government savings depleted, high inflation and exchange rate fluctuation. At that time Indonesian position is as a poor country that is considered reasonable to obtain foreign loans that can be used as a short-term rescue measures.Most of the loans from multilateral institutions and countries and donor countries that joined in IGGI. Foreign debt taken is to cover the gap both budget deficits and balance of payments deficits.

In line with economic progress achieved, Indonesian foreign debt continues to increase the number of the quite large and experienced a shift in the structure. The need of funds to cover this investment should come from domestic savings, but in reality almost all developing countries have problems funding limitations in financing development programs that have been determined. To cover the problem then the state is trying to bring in sources of funding, one of which is foreign debtsothat since 1969 the Government of Indonesia on a regular basis to finance the development through foreign debt.

While the shift in the structure of foreign debts of Indonesia may be seen from the increase in government foreign debt that is commercial and increasingly large proportion of private foreign debt. Especially for government foreign debt from the original priority to concessional loans turned into loans of a commercial

character as a rising economic growth in Indonesia. While the increase in private foreign debt is caused by the development policy is more directed at empowering the private sector in development.

Capital inflows, especially foreign debt it has contributed positively to the overall Indonesian economy. This is reflected in the development of some macroeconomic indicators since 2000 until 2004, among others, levels of GDP growth on average 4,6 percent per year and the next period GDP growth on average 5,5 percent per year in 2005 until 2010, Balance of Payment is always a surplus and international reserves sufficient to finance 70,296.70 million USD Imports (Annual report 2010).

On the fiscal side view of foreign debt is an important component in the state budget; the revenues can increase the ability of governments to provide investment funds so as to encourage the production and creation of employment opportunities. But despite the positive side of foreign debt there are also some factors that are the negative side in the use and management of the foreign debt, among others:

1. Dependence on external funding sources especially foreign debt, the use of foreign debt which was originally only as a complementary element in the end becomes the main source of development.
2. The absence of communicative restrictions on receiving foreign debt led to economic sectores competes with foreign debt that caused the swelling number of foreign debts.

3. The use of foreign debt was not accompanied by a more effective debt management and efficiency, giving rise to high-cost economics.
4. Many projects financed by foreign debt do not have the capacity to generate income sources for the repayment of foreign debt.
5. Too over confidence lenders provide to Indonesian foreign debt which pasa time economy is growing rapidly. This matter causes the dozing of several parties to rely on sources of funds financing the construction of the internal sector.

Negative side of acceptance and management of foreign debt are causing foreign debt burden of Indonesia in thus,day became increasingly heavy burden of foreign debt obligations was not only affect government finances, so as to incriminate the state budget in the coming years, but also cause a reduction in reserve foreign exchange needed to strengthen their balance of payments position, based on this matter not wrong if a lot of opinions saying that the economic crisis in Indonesia that occurred in 1997 also triggered by the large amount of foreign debt.

4.2.3 External Debt Development

Based on data from the International Monetary Fund, the amount of foreign debts of Indonesia from the year 2000-2010 was over 60 billions USD (see table 4.2), except in 2001 amounted to 58.79 billions USD because economics growth in that year lowest. In 2000 the amount of Indonesia's debt is 61.89 billions USD, where Interest rate loan and Installment debt is 4.39 billion USD and additional debt is 5.61 billion USD, due to government action to

stabilize the rupiah against foreign currencies, so this requires international reserves very large, while international reserves have previously been drained to face the public panic that rollicking buy dollars on a large scale with the assumption that the dollar will rise again. Based on the data obtained appears that the Indonesian foreign debts is always high amount each year, only in 2001 that experienced a decrease, and even then only a slight decrease. The highest amount of debt in 2003 which amounted to 68.91 because economics growth in the years increases.

Table 4.2 Indonesian External Debt (in Billions USD)

Years	Debt	Interest Rate Loan *plus* Installment Debt	Additional debt
2000	61.89	4.39	5.61
2001	58.79	4.24	5.51
2002	63.76	4.57	5.65
2003	68.91	4.96	4.00
2004	68.57	5.22	2.60
2005	63.09	5.63	4.00
2006	62.02	5.79	4.00
2007	62.25	6.32	4.01
2008	65.44	5.87	4.00
2009	65.70	5.65	5.00
2010	68.06	5.84	5.75

Source: UNCTAD

See the Interest Rate Loan *plus* Installment Debt each years above 4.00 billions USD. Interest Rate Loan *plus* Installment Debt highest in 2007 is 6.32 billions USD because the stability of a well maintained, Indonesian balance of

payments reached a surplus, rising foreign exchange reserves, inflation is stable. When the distinguished foreign debt into the government and the private sector, it is 52 percent and 48 percent of government debt is private debt. The most indebted in the private sector is FDI, followed by domestic investment, BUMS, and banking.

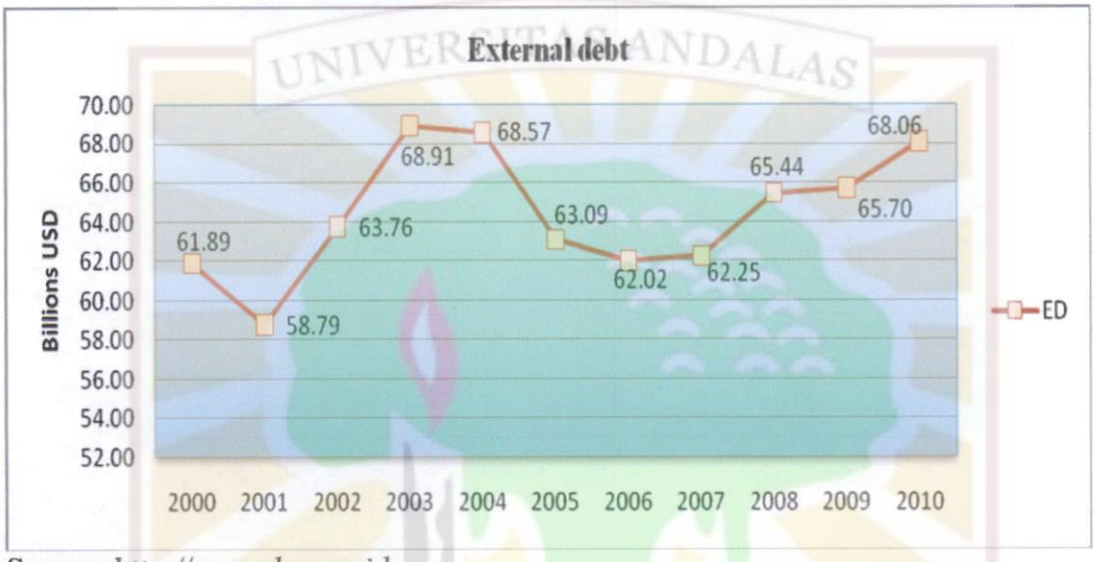
Considered could reduce the amount of debt on the contrary. Amount of precisely what happened instead of government debt tends to increase every year. With the increasing amount of debt can not be avoided the spike in mortgage payments of debt principal and interest on each year who become a burden the state budget. Ironically to pay the debt that includes mortgage principal and interest debt the government should pursue new debt. Amount of never sufficient to pay debt obligations in each year. For example in 2004 jumlah utang sebesar 68.57 billions USD dengan **Interest Rate Loan *plus* Installment Debt is 5.22** but the additional billions of USD 2.60 only. Total addition of the lowest debt during the year 2000-2010.

Based on these data it can be said Indonesia had entered into a debt trap that forced the government to "dig debt, pay debt" every year. ratio of debt to gross domestic product (GDP), which indicates an increase Indonesian capacity to pay debt tend to decline in each year.

If we observe the development of debt payment obligations every year it turns out has become an ever-greater burden burdensome state budget. Payment of interest and debt repayments are part of routine expenditure in the state budget. To cover this debt burden of the policy pursued by the government, among others, by

reducing fuel subsidies, raising tax revenue target and to boost privatization of SOEs. However, this impact is felt too charge people with a larger tax payments, as well as reducing fuel subsidies.

Figure 4.2 Indonesian External Debts



Source: http://www.dmo.or.id

Several economic factors affecting the increase in foreign capital inflows in the form of foreign debt, among others (Rahmat, 2001):

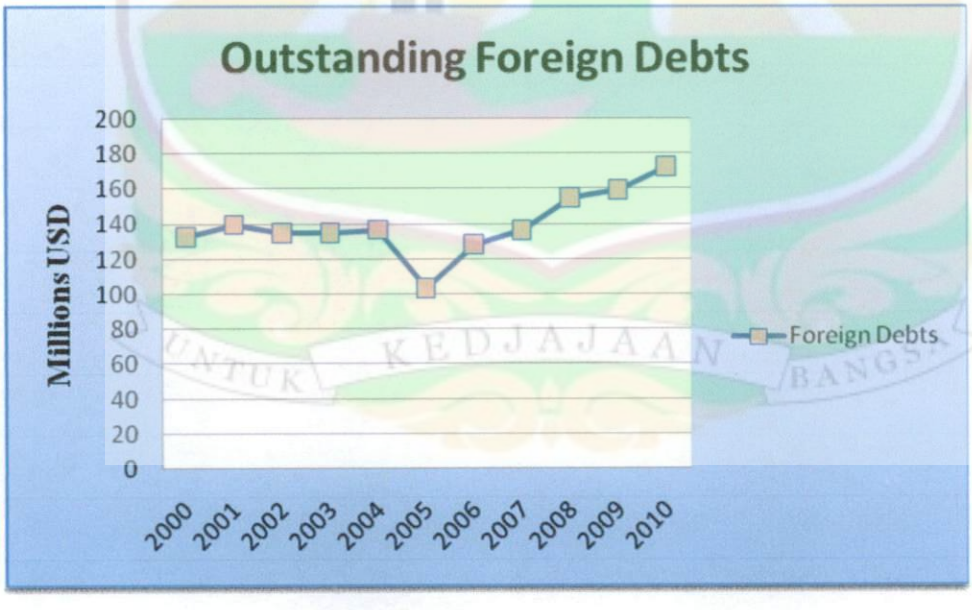
1. Free foreign exchange policies embraced by the government in Indonesia so that the owner of the funds freely enters into Indonesi or withdraw their funds without any restriction from central banks.
2. The rupiah exchange rate relatively stable against the USD. Led foreign investors can easily calculate the benefits and costs that may occur in one invest in Indonesia.
3. Interest rates are relatively high differentiation between the interest rate of rupiah to the USD and the level of USD appreciation against the dollar in governance at a certain level by the monetary authorities.

4. Large domestic market which makes the state of Indonesia as one of the emerging markets (emerging markets) the potential for foreign investors.

4.2.4 Outstanding external debt

Based on data from Bank Indonesia, total external debt position of Indonesia period from 2000 to 2005 posisi utang berada pada jumlah yang hampir sama besar but in 2005 total external debt position turun jauh menjadi 103.652 million USD, means that Indonesia's debt position was low because the number of Indonesia's debt also declined in that year amounted to 63.09 billions USD which previously amounted to 68.57 billions USD debt (2004) but in next year total external debt position continues to increase, ie from 2006 to 2010 (See Figure 4.4).

Figure 4.3 Indonesian Outstanding External Debts



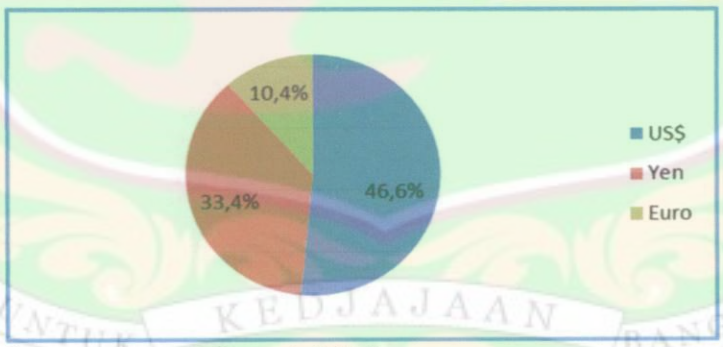
Source: Economics Report on Indonesia, (Various Edition)

In such a constellation, the question arises: whether Indonesia will have a debt crisis of foreign debt (included in the debt trap), or is still able to maintain the momentum of development?

State or Institutional Lenders

According annual report 2010, in view of Exchange Structure, foreign debts of Indonesia since the economic crisis until 2010 was still dominated by lending dollar U.S currency and is followed by a loan in exchange Yen, Euro. By type of currency, U.S. dollar-denominated loans reached 46.6% which still dominates the overall government foreign borrowing. While the position of foreign loans and yen-denominated Euro reaches 33, 4% and 10.4% (see figure 4.5).

Figure 4.4 External Debt Position of Indonesia according to currency type Period 2000-2010



Source: Annual Report, 2010

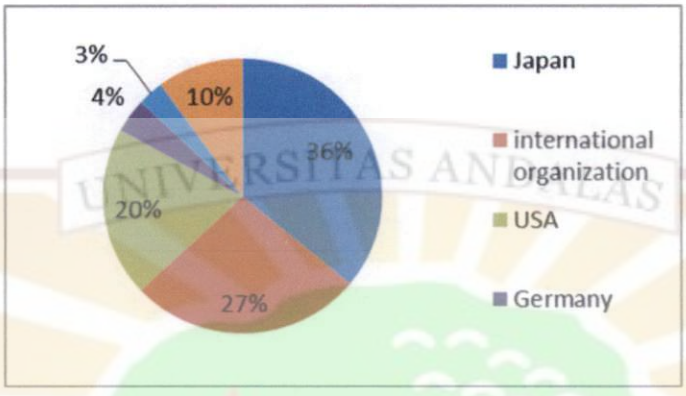
Whereas, External Debt Position of Indonesia by Group of Borrower:

- External Debt Position of Government by Top Five Creditor Nations from 2000 until now Japan is the largest creditor country that is 36 percent and is followed by international organizations lenders Indonesia is ADB's largest registration 27 percent, USA 20 percent, and Germany 4 percent, while France 3 percent and others 10 percent (see figure 4.6).

Figure 4.5

External Debt Position of Government by Top Five Creditor Nations

Period 2000-2010



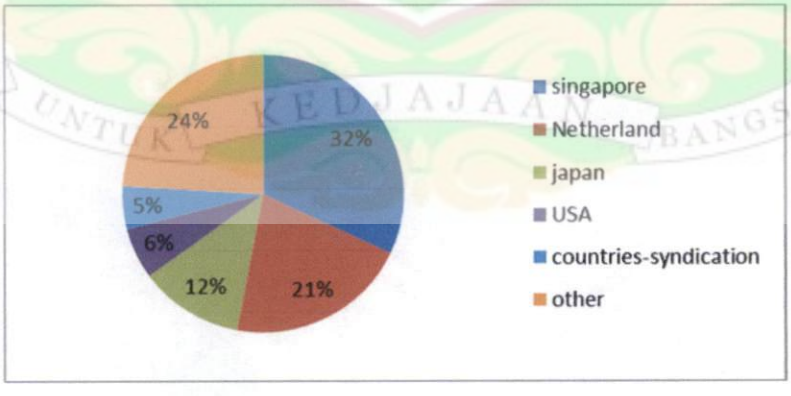
Source: Annual Report, 2010

- External Debt Position of Private by Top Five Creditor Nations Nations from 2000 until now Singapore is the largest creditor country that is 32 percent and is followed by Netherland 21 percent, Japan 12 percent, while Countries – Syndication 5 percent and others 24 percent (see figure 4.7).

Figure 4.6

External Debt Position of Private by Top Five Creditor Nation

Period 2000-2010



Source: Annual Report, 2010

4.2.5 Debt Burden Indicators of Indonesia

Indicators that show how the impact of foreign debt on the economy of the country is Debt Service Ratio (DSR), the ratio of debt/export ratio and debt/GDP that shows the power capability in fulfilling obligations of foreign debt. DSR will be a concern to donor countries in considering the granting of foreign loans, particularly loans granted to developing countries. This analysis is highly perceived importance, because experience has shown the existence of a number of developing countries have experienced an inability to fulfill the obligation to pay interest and installment loans, necessitating rescheduling (rescheduling) of repayment. However, this alternative resulted in the larger interest payment obligations and mortgage debt in the coming years.

In connection with the high burden of foreign debt. The World Bank set a safe limit the amount of foreign debt on 3 indicators: The ratio of debt payments to exports of goods and services, Ratio of total debt to exports and the ratio of total debt to GDP.

1. The ratio of debt payments to exports of goods and services (DSR) = 20.0%

Debt Service Ratio (DSR), which is the ratio between the obligation to pay the debt mortgage and abroad with a foreign exchange export proceeds. DSR safe threshold amount of economic experts says typically is 20 percent. More than that, the debt is considered to invite quite a lot of insecurity (see appendix 4).

Based on BI data, throughout the year 2000 to 2010 average DSR Indonesia over the safe limit set by the banks of the world except in 2005, in 2007 and Indonesia in 2008 where DSR below safe limits, respectively was 17.3

percent, 19.4 percent, and 18.1 percent. This means that throughout the years 2000-2010 Indonesia was in danger except in the three years mentioned above. This is evidenced by the decline in Indonesian GDP figure in 2009 of 4.5 percent, this led the government budget should be addressed to move the real sector even run out to pay interest and debt repayments.

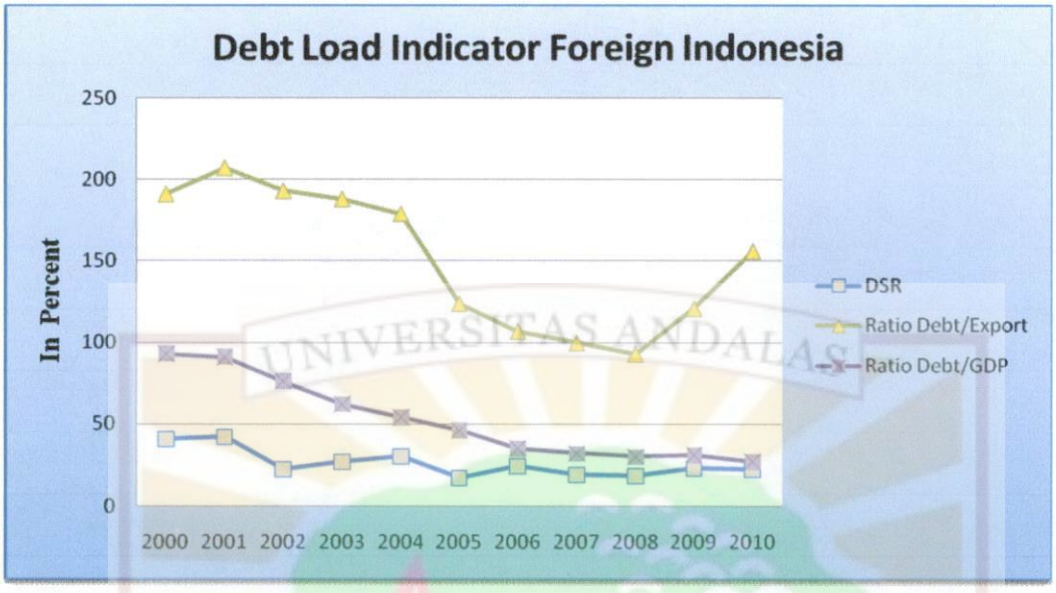
2. Ratio of total debt to exports is130-220%

Debt to Export Ratio which is the ratio of debt to exports. World Bank stipulates that a country is categorized as a heavy debtor nation, if the country concerned has a Debt to Export Ratio greater than 130 percent. In the year 2000-2004 dan di tahun 2010 ratio of debt to GDP past the safe limit which is set by banks means that Indonesia is the world's major debtor countries during the period of the period.

3. The ratio of total debt to GDP is 50-80%.

Debt to GDP ratio is the ratio of debt to GDP. The ratio of debt to GDP can be viewed as a criterion to check the financial health of a country, where the ratio above 50 percent indicate that Indonesian foreign debt to fix more than 50 percent of National Income (Basri, 2003:201). Base on the data in appendix 4 ratio of debt to GDP during 2000 to 2004 over the safety limit in the year means the financial condition of state within a state is not healthy. But in subsequent years the ratio of debt to GDP is in sound financial condition categories (see figure 4.2).

Figure 4.7 Indonesian Debt Load Indicators Foreign



Source: Statistics of Financial Economic Indonesia, (Various Editions)

As a consequence the amount of weight above, the first budget is expected to become increasingly difficult growth stimulus; because the portion is spent to pay the debt is too big. Second, there has been siphoned off massive funds from the public in the form of tax increases and various other fees that coincided with the reduction of various subsidies. Third, public funds are allocated to creditors outside the country (in the form of installments and interest of foreign debt).

The flow of funds out of the country will have an impact on the disappearance of funds and resources from domestic economic activity. Siphoned off these funds will reduce the disposable income people so depressed domestic demand. As a result of growth in domestic consumption as one of the keys in GDP growth can no longer play a role (Makmun, 2005).

4.2.6 Current Account

Another internal factor causing increased foreign debt for developing countries like Indonesia, the current account includes transactions relating to export or import of goods and services. In some developing countries current account surplus or deficit made in the indicators to see how much the country depends on foreign debt, deficit which occurred in the current account is then closed with the external debt situation negri.Analisa current account deficit of surplus or deficit are grouped into three groups:

- Deficit of trade balance > services balance surplus
- Deficit Deficit services balance > big trade
- Services balance of trade deficit with service account deficit of the three classifications of the deficit that occurs in the current account.

In Indonesia included in the classification into two (deficit deficit service> large commercial). current account covers two transactions relating to exports and imports of both goods or services within a certain time. In addition, surplus and deficit in the current account can serve as a tool to see how big a country dependent on foreign debt. In Indonesia the current account tends to negative because the number of mortgage payments and interest is very large foreign debt and the total export and import smaller than the deficit on the balance sheet plus a number of services.

Based on the data bank Indonesia Indonesia Current account since the year 1980 to 1997 was always a deficit due to export of goods or services of high and low while new import has increased in 2000 with the increase in export, import, service and current account, respectively is 65,408 Miliions USD, 40,367 Miliions

USD, 17,050 Miliions USD, and Current account is 7992 miilions USD. The highest current account is 15,630 Millions USD in 2004 with the increase amounted to 70,767 exsport Millions USD and imports amounted and services -50 625 Miliions USD and -8811 Millions of USD (see appendix 5).

According syaparuddin (2003) on economic governance fit in a journal on Foreign Debt in view of the demand side the period 1980-2002 that the current account deficit had a positive correlation to the government external debt/demand. This shows the greater the current account deficit but statistically in the model estimation foreign government debt demand, the influence of the current account deficit on external debt is not significant demand addressed by the smaller value of t-statistics.

When the export merupkan one component in the current account empirical evidence of a causal relationship export and economic growth in developing countries means that current account relationship with Foreign Debt implied value of export reasons that become components of current account to determine whether deficit or surplus nreaca walk, resulting in an automatic state will make loans abroad if the following assumptions Foreign Debt load urgency in current account deficit.

The reason for creditor countries to lend another country (debitor countries):

1. To help recipient countries to accelerate their economic development
2. Establish economic relations and politic among borrowers with countries receiving aid.
3. Stem influence conflicting ideologies adopted by the state aid.

On the ideological side, foreign debt is believed to have been used by the lending countries, especially America, as a means to disseminate neo-liberal capitalism all over the world. By wearing the foreign debt as a means to disseminate kapitaliseme neoliberal, mean foreign debt has been deliberately used by countries to deplete the world's lender (Erler, 1989), while on the social and political implications, foreign debt is not only viewed as tool was developed by the countries lenders to intervene loan recipient countries.

Indirectly he also believed responsible for the emergence of dictatorial regimes, environmental degradation, increasing the pressure of migration and trafficking of illegal drugs, as well as to the occurrence of conflict and war (Gilpin, 1987; George, 1992; Hanlon, 2000).

4.3 Indonesian Foreign Direct Investment

Many developing countries, including Indonesia, are increasingly dependent on foreign capital flows, whether in the form of loans, aid (grants), and investment in the form of FDI and FPI preformance. This is due to dire need and for investment, while domestic sources of funds are very limited, (TH Tulus Tambunan, DR, and Loc.cit.p 42).

Foreign direct investment is investment by foreign private to a particular country. The form can be a branch of a multinational enterprise, licensing, joint ventures, or other. Besides the form of foreign direct investment, private foreign investment may also be capital investment portfolio. This type of investment is a capital investment in the form of ownership letters Long-term loans and the shares of companies located in developing countries, so just a form of participation in the

ownership of the company and not the company's mastery of everyday activities (Sukirno, 1981, hal.381).

4.3.1 Type of Investment

Foreign investments are divided into two parts. ***First;*** Foreign direct investment (direct investment) that through the investors participating in the management company to obtain benefits from their capital invested. Direct Investment is a form of investment in road building, purchased or acquired company's total. ***Second;*** Foreign portfolio investment (Foreign Portfolio Investment, FPI) is an investment by an individual, company or legal entity (eg local and national goverment in various foreign financial instruments (eg government bonds, foreign stocks), the FPI does not involve control of the company's ownership in a foreign business entity.

The tendency of the formation of Indonesia to direct investment so far, reflects the pragmatism that characterizes the development of our economy, when faced with the choice between external debt or foreign investment, is more rational to choose foreign investment, mainly on the basis of a lower level of risk. Foreign direct investment usually permanent or long term also contributes to over teghnology, transfer of management skills and creates new jobs. Compared with the portfolio investment through stock exchanges with securities instruments such as stocks and bonds.

Foreign direct investment has several advantages, among others, *first;* more direct foreign investment to give a sense of security for the host (Host Country) from the risks that occur due to the economic development of

contemporary, often dramatic, mainly due to changes in currency appreciation. (*Kuntjoro Jakti, Ekonomi Politik di Asia Pasifik, Jakarta, Erlangga,1995, hal.128*).*Second,* foreign direct investment can direct labor, capital, and teghnology with the ways and measures that can be rivaled by any other form of surgery.

But foreign direct investment is not the only factor that transforms economic relationships around the world. Investment portfolios are also actively linking the economy to various countries and is growing rapidly. Even in meaning of dollar, investment flows portifolio, ie movement of money internationally to seek big gains in the currency markets and financial markets, far beyond the direct foreign investment.

On the other hand also invest directly in order to create or expand a permanent possession (permanent invterest) in a company. Foreign direct investment also refers to the participation of management and control are also effective. Even more important is the transfer teghnology, management skills, production processes, improvement and marketing, as well as other resources. Koseptual difference between foreign direct investment to portfolio investment is that FDI requires control by investors while the FPI is passive does not require management effort by the investor (Henri, 2000).

Since the old order collapsed in 1966 under the Soeharto government, the growth in FDI began in 1967. New Order slowly reveals them as a country that can be trusted to invest. Foreign investment in view as a solution to accelerate economic growth in Indonesia, marked by the keluarkannya Act No.1 of 1967 on

Foreign Investment, according to the law, the definition of foreign investment is just covering foreign direct investment is done according to law These laws are used to run the company in Indonesia, in the sense in which the owners of capital are directly bear the risk of such investments. Then amended by Government Regulation No.20 of 1994, whereas in the PP government allows investment capital in 95% controlled by foreign capital. (Economic Report of Indonesia, 2002).

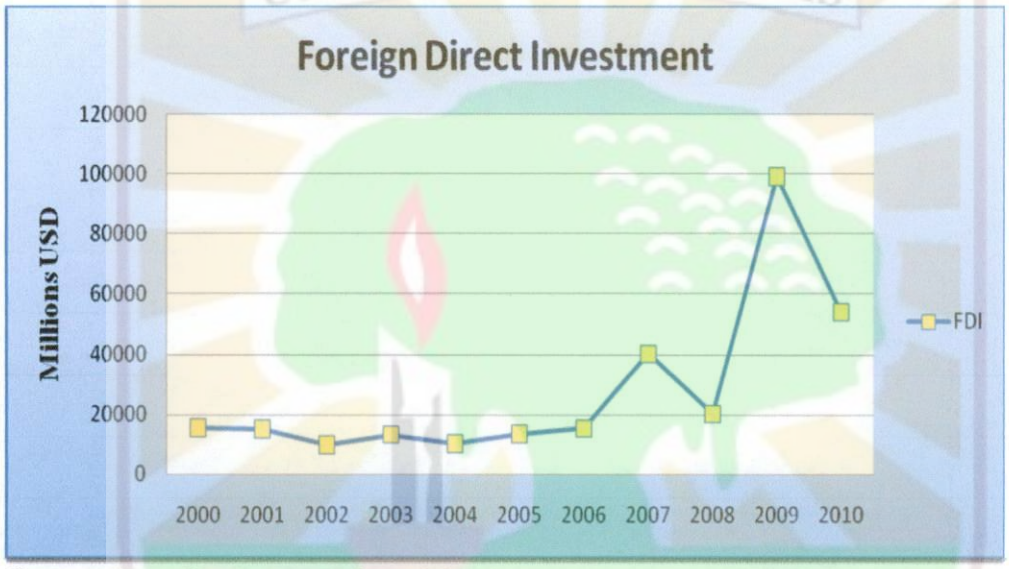
As the impact of foreign investment, we can say that the state procurement of infrastructure, establishment of new industries, the utilization of new sources, all of which tend to increase employment opportunities in the economy. In other words the import of capital to create more jobs. These circumstances is an advantage in the presence of foreign investment.

4.3.2 Foreign Direct Investment Development

After the economic crisis in Indonesia again increased FDI in 2000 which amounted to 15413,1 million USD. This is something to do with the political climate improve compared to previous periods that minimize doubts prospective investors to invest in Indonesia. After 2000 the economic growth of FDI continues to increase, except In 2002 but dropped to 9744.1 million USD. Because some respondents said Indonesia's investment environment has increased, especially less this infrastructure to encourage increased investment into Indonesia. This situation continued until 2005, even FDI through GDP.

In 2007 FDI increase to 40145.2 millions USD because in that year macroeconomic condition is stable. In 2009 increase because public trust to plan government system, its condition make investment increase. Furthermore, in the next year FDI in Indonesia decrease because fluctuation market (see figure 4.8).

Figure 4.8 Indonesian Foreign Direct Investments



Source: http:// www.unctad.org/wir

Rise and fall of total foreign investment in Indonesia reflects bad climate of investments in Indonesia. Sarwedi (2001) hypothesis suggests that investment in a country decreases when a country in an unstable condition and vice versa. If seen in the New Order era, the rapid growth of investment and FDI proved as driven by political and social stability, legal certainty and economic policies conducive to business activities in the country.

Actually there are two problems that affect the FDI activity in a country (host country), in relation to why an active state in attracting investors to invest their money in a country, namely Policy and Economics framework determinant (Sarwedi, 2002). Policy framework, with particular regard to the applicable

regulations in a country. Investors basically know how the potential and conditions of a country that will make an investment location, this policy framework related to the rule that supports open markets, standardization of international agreements, the ownership factor and others. UNdata (1998) in Sarwedi (2002) descbibes this in several ways, namely (1) economics stability, political and social, (2) rules that support the entry and operations of business, (3) standards of international aggrements, (4) policy the functioning and structure of the market, (5) international aggrement on FD, (6) the policy of privatization, and (7) trade policy and taxation.

So far, many economists believe that FDI can promote economic growth, but there are some arguments which oppose foreign investment especially from the business activities of multinational corporations in various countries in the third world. ***First,*** multinational corporations, in reality, precisely to reduce domestic savings and investment in the host country due to a form of unfair competition is based on exclusive production agreements between the parties with the multinationals in the host country government, non-performance of their reinvestment of profits found in the host economy, terpacunya domestic consumption levels that would discourage people to save or invest the extra income.

Second, in the short term, multinational companies can indeed improve the foreign exchange host countries, but in the long term it reduces the negative impact of foreign exchange earnings, both in terms of the current account and capital account. The current account could deteriorate due to the massive import

of intermediate goods and capital goods by multinationals and the worsen again with the delivery of results benefits interest, royalties and management fees to their home country so that the host country did not receive a fair profit. ***Third,*** although a member of multinational enterprises can contribute to government revenue through taxes, but in practice these contributions is much smaller than they should. It is caused by the tax concessions that are liberal, granting excessive investment facilities, hidden subsidies and others.

Nevertheless, despite these views, the Indonesian state is still much need of a helping foreign investment. In the background belakingi by saving ability Indonesian society is not perfect so that capital requirements in the country is still lacking, there are many sectors that can not be managed solely by labor and management in the country and yet efficient production for certain types of commodities, so it is more profitable if the management is handed over to foreign investors, where foreign investment has brought new technology and other useful knowledge for development in the country.

Factors that could be a motivation for foreign investors to conduct FDI in a country are:

a. Access to Minerals/Natural Resources

   The orientation of foreign investment is only to obtain resources more cheaply and efficiently where the resources in their home country is no longer sufficient, but it can be oriented towards trade in which countries willing to import commodities investor who has lost its comparative if it is produced in the country of origin of investors.

b. Avoid tariff barriers

Rates for a product that will go in one country could hamper trade routes and to reduce the level of profits, so that founded the company in the country was an attempt to avoid the tariff.

c. Domestic Market Oriented

The market of the host country is very promising and can obtain more profit than is produced in the country of origin itself.

d. The level is relatively low wage workers

Most wages in developed countries has been too high when compared with the capital and new product development more capital intensive and knowledge so that an alternative to open or establish industrial enterprises in other countries become more profitable, especially if countries aim to have wage labor is cheaper than the state origin.

4.4 Indonesian Domestic Saving

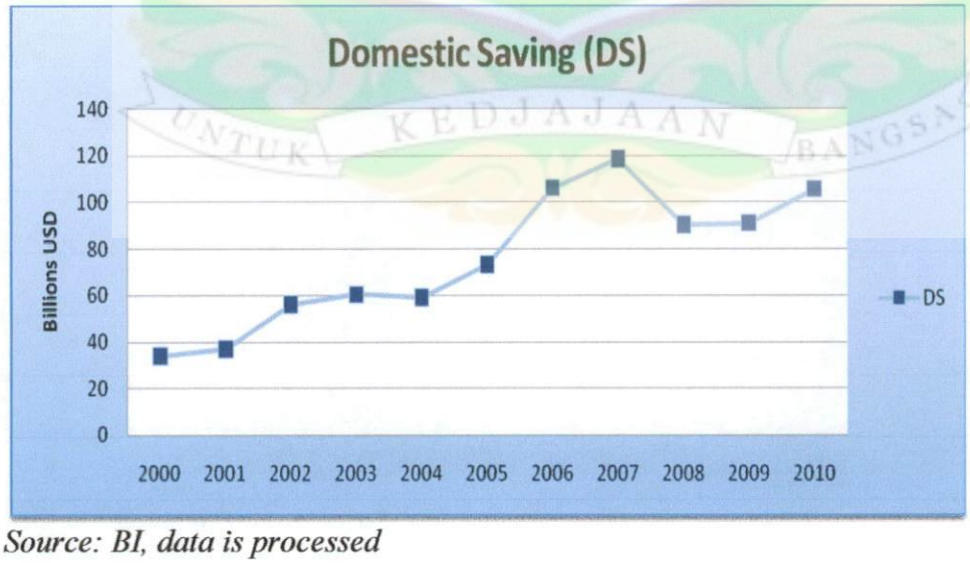
Savings according to the classical theory is a function of interest rates. The higher the interest rates higher the public's willingness to save. This means that at a higher level of community interest will be more motivated to sacrifice or reduce spending for investment in order to increase savings Contrary to the opinion of Keynes that, the savings will be undertaken by households rather than depending on the interest rate but on the size of the household income.

In countries that are developing as well as Indonesia does not have sufficient financial resources to finance the construction of their cities. The limited accumulation of capital in the domestic savings. This is one of the causes

of low foreign investment in Indonesia, due to low domestic savings which are a source of capital in financing the development because economic growth fell and the condition causes low foreign investment. In general, the saving-investment gap value is negative. However, when traced over the source of the deficit comes from the private sector and SOEs. The central government seems to always be able to finance its investment from government savings.

Base on the annual report of BI data Indonesian domestic saving in 2006 is very exciting because all of 2000 to 2010 has never been our domestic saving over 100 billions USD and the highest amount of domestic saving in 2007 is equal to 118.52 billions USD Because high interest rates so that the investment also rose in 2007 (see figure 4.9), but down again in 2008 and 2009 That Are Millions of USD 90.16 and 90, 87 Millions USD Because cases have an impact on the lost century of public trust in the bank in 2010 Than ant increase of domestic saving again to 105.62 Millions USD Because SBY have a program to promote savings.

Figure 4.9 Indonesian Domestic Saving



Source: BI, data is processed

CHAPTER V

EMPIRICAL RESULT AND POLICY IMPLICATIONS

5.1 Emperical Result

In this chapter the author will express quantitatively how the effect of foreign debt and foreign investment to the Gross Domestic Product in Indonesia, then in doing regression analysis of the equation, while the method used in the regression is the method of Ordinary Least Square (OLS) using the software eviews program version 6.0 After the regression of the data, (in the form of data times the annual series) was obtained regression results as follows:

$$LOG\ \text{GDP} = \beta_0 + \beta_1\ LOG\ ED + \beta_2\ LOG\ FDI + \beta_3\ LOG\ DS + \varepsilon$$

$$= \text{-3.298557+ 1.731437 ED + 0.264540FDI + 0.810841DS}$$

T-test = (-1.654749) (1.537341) (3.030101) (5.101240)

Adjusted R-squared = 0.899198

F-statistic = 30.73492

Durbin-Watson stat = 2.404034

5.1.1 Econometric Estimations

1. The coefficient of determination (R^2)

From the regression results obtained value Adjusted R-squared is 0.89. This means that the dependent variable by 89% Gross Domestic Product (GDP) could be explained by the independent variables External Debt (ED), Foreign Direct Investment (FDI) and Domestic saving (DS). The remaining 11% is explained by other factors outside the model used. If the External Debt (ED), Foreign Direct

Investment (FDI) and Domestic saving (DS) is considered constant then there are other factors that can increase the Gross Domestic Product, which can be viewed on the value that is -3.298557βo.

2. F- test

Independent variables jointly affect the dependent variable if the value of the F-test> F-table, and vice versa, the independent variables jointly do not affect the dependent variable if the value of the F-test <F-table. From the results, the F-test value of 30.73492, while F-table calculated by df1= k-1 and df2 = n-k-1, where k is the number of dependent variables and independent variables, while n is the number of data so obtained value of the F-table (2: 7) is 4.74 (significant at 0,05). This shows the value of the F-test > F-table, and can be stated that the External Debt (ED), Foreign Direct Investment (FDI) and Domestic saving (DS) is jointly significant effect on the Gross Domestic Product (GDP).

3. T-test

Results of regression analysis found that value of T-test for the foreign debt is 1.53 less than T-table 2.36. its mean foreign debt is not significant on gross domestic product. For the results of regression analysis found that value of T-test for Foreign Direct Investment (FDI) is 3.03 greater than T-table 2.36. its mean FDI is significant on Gross Domestic Product and results of regression analysis found that value of T-test for the domestic saving is 5.10 less than T-table 2.36. Its mean DS is significant on gross domestic product. So, we conclude that ED is significant positive but ED is not dominant influence on GDP, in the other hand

both variable such as FDI and DS are significant positive influence on gross domestic product.

5.1.2 Classical Test

To produce a linear unbiased estimator (best linear unbiased estimator = BLUE) of a equation multiple linear regression with least square method (OLS), the regression model that is used must meet the classical assumptions.

1. Test multicollinearity

The multicollinearity test is used to see the classical linear relation between the independent variables in regression model. If the $r > 0,85$ it means there is multicollinearity and if the $r < 0,85$ there isn't multicollinearity. Based on the results shown in appendix 6. All values $r < 0,85$, it means that variables doesn't have multicollinearity. Thus the regression model with OLS method is doesn't contain multicollinearity.

2. Test Heteroskedatisity

Another important test of classical linear regression is heteroscedasticity test. For testing the heteroscedasticity use the *white heteroscedasticity no cross terms* in which if the probability (Obs*R squared) > 0,05 it means there isn't heteroscedasticity, the result of the research, based on *white heteroscedasticity no cross terms* which appears from the table above there isn't heterocedasicity in whcih the value of chi-square probability is bigger that 0,05 that is 0.46 > 0,05.

3. Test of Autocorrelation

The autocorrelation Test can be detected with LM test which is developed by Breysch-Godfrey (*Lagrange Multiplier Test*). The LM test will give the result

of there is autocorrelation or not where if the chi-square probability (Obs*R-squared) is bigger that 5% it indicates that there isn't autocorrelation. Based on LM test with lag 2 the data have chi-square probability (Obs*R-squared) is 0.28 So, higher than 0,05 it mean that the regression don't have autocorrelation.

4. Normality Test

Normality test aims to determine the distribution of data variables used in the study. Good data and fit for use in research is data that has a normal distribution. Normality of data can be seen from the skewness of inclination (slope) of a curve. Near-normal distributed data will have a skewness value near zero slope tends to have balance. (Nugroho, 2005). From the regression results using data from 2000-2010 (n = 11) obtained skewness value of -0.17 so that it can stated that the model is normally distributed and fit for use in research.

5.1.3 Effect of independent Variables on the dependent variable

To see the effect of each Independent Variable on the dependent variable can be done Test of t-statistic. Partially significant test for each free variable can be seen from the significant amount of free t each variable.

5.1.3.1 Effect of External Debt (ED) on Gross Domestic Product (GDP) Indonesia.

From the multiplier regression, We can get the result of the data that the value of variable T-test of th $df1 = \alpha/2 \; and \; df2 = n - k$ so that they obtained value of T-table $_{(0.025;7)}$ at 2.36 when T-test is 1.53. T-test mean value < T-table values. Regression coefficient for ED is 1.731437, its means that each increase of 1% of external debt would increase the GDP of Indonesia for 1,7 % with

assuming other variables constant. These results indicate that the external debt associated with Indonesia's GDP positive but not statistically significant.

From the results it can be concluded that basically, in the process of implementation of economic development in developing countries like Indonesia foreign debt accumulation is a common symptom which is reasonable because of low domestic savings do not enable adequate investment made so many developing country governments must draw funds and loans from abroad. External debt is an important component in the state budget, which accepted can increase the ability of governments to provide investment funds, thus encouraging the production and creation of employment opportunities which in turn can increase the GDP of Indonesia.

However, the use of foreign debt that is not wise, and without principle of vigilance, it will plunge the long term debitor countries into a debt crisis that prolonged overseas. Indonesia's foreign debt was originally only as a supplementary fund but it will eventually become the main source or mainstay in development. The absence of quantitative restrictions on receiving foreign debt led to economic sectors, vying use foreign debt, so the amount of foreign debt soared. This matter reflected from the DSR number and ratio of debt/GDP of Indonesia, especially during the financial crisis in which the ratio was respectively 23.1 percent and 31.5 percent.

In addition, the use of foreign debt was not accompanied by higher priority to debt management effectiveness and efficiency, causing a high cost economics. Many projects financed by foreign debt haven't capacity in generating sources of

income for foreign debt repayment. Too much foreign debt is allocated to routine expenditures that are consumptive, rather than on routine expenditures that are productive. This matter eventually have an impact on government finances so burdensome RI state budget in subsequent years, because of foreign debt must be paid in installments plus interest thereon. This also causes a reduction in international reserves in the need to strengthen the balance of payments position. So the foreign debt will increase GDP if the amount of foreign debt are on the safe limit set in the world bank and its management is done properly, effectively and efficiently.

Base on the regression result of this research, so this research along with research by Durbarry, et al (1998) in Afees Adebare.S (2007), Pattiloo, et al, (2002, 2004) in Tambunan (2008), which identified that the impact of external debt on economics growth is positive but often not significant. This contrasts with the results of research by Durbarry, et al (2007), show that debt variables to be significantly negatively correlated with investment or growth and Sritua Arif and Adi Sasono (1987), in the period 1970-1977 obtained evidence that the foreign debt with foreign direct investment and the negative effect of foreign debt was also continuously decreased ability to finance imports of goods and services.

5.1.3.2 Effect of Foreign Direct Investment (FDI) on Gross Domestic Product (GDP) Indonesia.

T-test value of the variable FDI is 3.03 while the T-table values are calculated by means $df1 = \alpha/2 \; and \; df2 = n - k$ thus obtained value T-table$_{(0.025;7)}$ amounted to 2.36. T-test mean value > T-table values with the regression coefficient is

0.264540, meaning that for every 1% increase in FDI will increase the GDP of Indonesia for 0,26%, assuming other variables constant. These results indicate that FDI is related to positive and significant impact on Indonesia's GDP.

FDI became one source financing (capital) is important for Indonesia because it is able to contribute significantly to the development through the transfer of assets and management, knowledge and the transfer of technology to stimulate the state economy. Indonesia desperately needs FDI caused by many factors. First, the ability to save our society is still not perfect so that the capital in the country is still lacking. Second, there are many sectors that have not been in their own governance by labor and management in the country. The third has not been efficient for the production of certain types of commodities so it is more profitable if the management is handed over to foreign investors.

The study is in line with research conducted by Borensztein, (1998). who said that the contribution of FDI to economic growth should be positive and significant to the development in Indonesia. But research is not in line with research Kustianto and Istikomah in Sarwedi (2002) in his study of the role of foreign investment on economic growth during 1977-1966. They conclude that in the short and long term, FDI does not affect economic growth because (1) Country risk is a small domestic market so that the rate of return of low capital and lack of availability of facilities and supporting infrastructure (transportation, skilled labor, technology), (2) development of FDI is still hampered by the complexity of the management, bureaucracy and lack of coordination among relevant ministries; (3) still lack information on the source of funds used for

Project Financing, (4) low quality of human resources, and therefore contributes to the goals of foreign investment in a country, (5) the occurrence of intense competition between nations in attracting foreign investors either by developed countries and developing countries. The results of this study prove that Indonesia still needs to conduct a series of improvements, deregulation and strengthening of networks that will create a conducive investment climate as expected by foreign investors.

5.1.3.3 Effect of Domestic Saving (DS) to Gross Domestic Product (GDP) Indonesia.

T-test value of the variable DS is 5,10 while the value T-table are calculated by means $df1 = \alpha/2 \; and \; df2 = n - k$ thus obtained value T-table$_{(0.025;7)}$ amount to 2,36. T-test mean value > T-table value. The regression coefficient is 0.810841, means that each increase of 1% DS will increase the GDP of Indonesia is 0,8% assuming other variables constant. These results indicate that the DS touch the positive and significant impact on Indonesia's GDP.

Result of this research similar with the study is in line with research conducted by Durbarry (1998), Islam (1992), who said that the domestic savings positive effect on GDP but this contrasts with the results of research by Agung Nusantara (2001) and Sritua Arif (1987), while domestic savings variable is negatively related to economic growth.

Large domestic savings in the banking institutions will be channeled into investments which will further be used to improve GDP. This is in line with that suggested by the Solow model that if the savings is high, the economy will have a

large capital stock, on the contrary, if savings are low, the economy will have a smaller capital stock and output levels are low (Mankiw, 2003).

5.2 Policy Implication

To analyze the impact of external debt, FDI and domestic saving toward economics growth in Indonesia, we can see from the policy issue to enhance economics performance in Indonesia. The literatures review in this study shows external debt, FDI and domestic saving variables have affect to increase economics growth, it is found in many countries. The previous studies investigated that FDI and domestic saving have significant positive influence to economic growth so, the result in this study is same with the previous researches in another country. Thus, another author found that external debt significant negative affect to economic growth in many countries but in Indonesia found a different result where external debts positive but not significant affect on gross domestic product.

The important source to support the significant effects of economic growth on growth is FDI and domestic saving. FDI (Foreign Direct Investment) as an important source of capital and measures the medium and long-term ability of a country to attract investment from abroad. An increase of capital inflows FDI often associated with new job opportunities, enhancement of technology transfer by this means boosting overall economic growth in host countries. Theoretically, FDI has played important role in order to decrease poverty and the next will increase economic growth in Indonesia. The theory is appropriate with the real condition. Whereas the empirical result shows that FDI and domestic saving is

significant positive affect to growth but the theory is not appropriate with the real condition for external debt while it's not significant to the increase economics growth in our country. The policy of Indonesian government to increase economic growth for example with increasing investment and saving also, therefore it is necessary to simplifying the process of permits and the integration of inter-departmental coordination through cutting the bureaucracy, and transparent application of tax incentives in the form of tax holiday that is still new for many years.

For supporting the government policy toward the increasing growth in Indonesia, the government supposed to enhance Indonesia trade performance through fiscal policy such as increasing on total export or trade openness must be followed with the equal distribution of FDI to each regional in Indonesia. Meanwhile, monetary policies also play an important role to stimulate the trade with stable inflation. So economic growth will increase and it gives effect toward poverty reduction.

CHAPTER VI

CLOSING

6.1 Conclusion

Based on the analysis and discussion that has been described in previous chapters it cans be concluded as follows:

a. The first hypothesis states that the external debt has a negative and significant impact on gross domestic product. Contrary to the results of this study, where the empirical Findings Show That the external debt has a positive impact on Gross Domestic Product in Indonesia but not significant. This is caused because of the many projects funded by foreign debt does not have the capacity to generate income sources for foreign debt repayment and more foreign debt are allocated to routine expenditures of government, this will burden the state budget because of state budget funds depleted to pay foreign debt and debt interest continues to swell.

The use of foreign debt is basically to increase the Gross Domestic Product in Indonesia because of foreign debt is one component in the state budget, the revenues in providing financial investment, so as to encourage the production and creation of employment opportunities but the use of foreign debt that is too large and that management not appropriate to plunge the debtor countries in protracted debt crisis. Allocation of funds requires more stringent supervision of the competent institutions to prevent corruption related to bureaucratic apparatus in the recipient country; there was capital

flight, high interest rates in the country let alone his under cover superpower strength due to the country's dependence on foreign capital, especially foreign debt.

b. The second hypothesis states that Foreign Direct Investment has a positive and significant impact on Gross Domestic Product. The empirical Findings show the same result, FDI has contributed a transfer of assets and management, knowledge and technology transfer to developing countries including Indonesia, in addition to the ability of communities that have not been perfect cause less capital needs within the city, so it needs foreign investment.

c. The third hypothesis states that domestic saving has a positive and significant impact on gross domestic product. The empirical Findings show the same result and domestic savings that is one source of financing for development, as a source of capital, the government must make efforts to increase domestic savings both from the government or saving savings society. Due to the high value of savings will increase the financing of capital investment would later become the state does not have to seek funds from overseas again.

Based on the overall results of all independent variables (External Debt, FDI and Domestic saving) significant positive affect on dependent variable (GDP), which were found by F-test greater than F-table but in Partially FDI and domestic saving variable is only significant positive on GDP and External debt variable is positive but not significant affect to GDP. We found by T-test value or coefficient value of external debt show the lower value compare with the other variable independent in this study. This result show that a better

source of capital or a big contribution to growth in our countries is FDI and domestic saving while External Debt not necessarily give a little contribution in improving the country's economic growth due to source financing from foreign loans have a high risk going forward (because interest rate loan and installment debt), Therefore, the development financing needs should take precedence over domestic sources of non-debt funds. Because, after all the debt burden will make the fiscal budget is not healthy. By optimizing the sources of non-domestic funds is expected Indonesia's debt to get out of debt trap.

6.2 Recommendation

Based on regression results in this study can be concluded that FDI and domestic savings that contributed bigger and better than external debt, this can be seen from the regression results where the value T-test or the value of external debt variable coefficient indicates a lower value than on the other independent variables. This suggests that the role of foreign debt in our country, not so great influence on improving Indonesia's economic growth in because of overseas debt is a source of loan funds that have an impact in the future that is the difficulty in payment of interest rate and installment debt, other negative impacts if the country depends on foreign loans is the emergence of the debt crisis (dig the hole closed), see the contribution of foreign debt of small and large risks to economic growth, the things that need to be done is to increase sources of capital derived from investment and domestic saving our country.

There are some recommendations that can be given as a contribution to increase economics growth with increasing foreign direct investment and domestic saving. As for how that is by creating a conducive investment climate for the implementation of investment projects, simplification of bureaucracy, a stable economic stability and a conducive security situation and law enforcement that will attract foreign investors to invest in Indonesia. As we know that, If the distribution of FDI is balance to all of regional, their will grow up together. Growing up of FDI not only stimulate new job opportunities but also absorb unemployment, and make many workers get income and any transfer technology also etc. to increase domestic savings could be made in various ways such as maintain a stable interest rate because when the interest rate is high then the savings will be high and vice versa and enhance the function of banking and non-bank financial institutions which will lead to trust people to save money so as to create a climate conducive to the development investment.

If it can be realized then, the state will obtain adequate financial resources from investment and savings, so do not necessarily always make borrowing abroad to meet the source of funds for financing the country's development and is expected eventually to reduce our country's dependence on foreign debt due to the fact that the amount of Indonesian foreign debt has increased every year, although a little contribution to growth It is the fear will worsen the economic condition of our country going forward.

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