

CHAPTER 1

INTRODUCTION

A. Research Background

The economy is basically a long-term macro-economic issue which each period the people try to improve their abilities to produce goods and services. The goal can be in the form of an increase in real output or national income and living standards or real income per capita through the provision and deployment of the factors of production. Thus, economic growth is a function of a neoclassic production with the assumption that all inputs to the production as a whole can be grouped into three factors: capital, labor, and technology. The production function describes how the three factors above combine economic input to produce output as measured by Gross Domestic Product (GDP) of the country. (Leasiwal, 2013)

Generally economic development also aims to achieve economic growth. Economic growth is quite high, maintaining the country's economic balance and equitable distribution of income. The existence of economic development may be driving economic growth, because economic growth will facilitate the process of economic development. With high economic growth, the people's welfare will be clearly seen, because the high economic growth of a country is expected to absorb the existing workforce. The economic development of a country can be shown by the growth of Gross Domestic Product (GDP). (Haryanto, 2013)

From the explanation above Can be concluded Economic Growth is one of the most important things in every country, where Economic growth is usually measured by the growth of GDP (Gross Domestic Product) of a country. Economics can also be interpreted that the development of a country's economy in each period becomes a better economy. A country's economy is seen from national income, where when production increases, national income will also increase, which will be seen from the increasing value of GDP. A country's economic growth will increase when its aspects has been fulfilled, aspects that can increase that growth. Such as factors - factors that affect a country's economic growth, for example, such as government spending, FDI, unemployment, technology, and various other things. These aspects must be considered every fluctuation that occurs so that the economy improves.

Economic growth is a process of changing economic conditions a country is continuously heading for better conditions during certain period. Economic growth is one of the most important indicators that must be considered by each country globally. The most important indicator for the welfare of a prosperous social life. Economic growth becomes an important thing to learn because every country also always explores things that can increase the country's economic growth in the long term. Therefore it is good to know what factor can increase the economic growth of a country. What is the indicators that are the most significant in influencing economic growth, so that the government can optimize the role in conducting

policies, various ways of a country to achieve economic growth, such as foreign direct investment is one way to increase capital stock, marketing networks, and technology which all have an important role in Indonesia's economic growth.

Beside foreign direct investment, government expenditure and unemployment also have an impact on economic growth. Government expenditure is the consumption of goods and services carried out by the government as well as financing carried out by the government for government administration and development activities (Sukirno, 2002). Government expenditure is one of the important indicators where the government plays an important role to take policies that must be done when using the budget. Government expenditure is usually set every year and used for state development, infrastructure and so on. With this fiscal policy, the government can invest in things that are useful for the country such as infrastructure development that can increase employment and reduce the number of unemployed in Indonesia, it certainly has an impact on the country's economic growth that is able to create social welfare and also reduce a country's poverty rate.

Economic Growth is one factor that can influence the economic development of a country. Where when the equitable development occurs the social welfare will be created. economic development can be interpreted as a country's growth in all aspects, especially in the economic sector which can usually be measured through the GDP (Gross Domestic Product) of a country that usually shows the growth of the economy. to actualize the progress of a nation and state the role of the

government and also the community is very important in managing and allocating natural resources as well as human resources, where Indonesia is one of the countries that have such large natural resources that can be optimally managed by the government in order to create job field that can reduce unemployment and poverty to create a prosperous social life. Where, it will have an impact on the Economic Growth. When economic growth has been formed properly will be followed by economic development. Every country has a purpose to archive the economic growth because as known that economic growth can be created social welfare and reduce the amount of poverty in the country.

Sulistiawati (as cited in sodik, 2005) concluded that the economic growth of the regional country mainly driven by the investment that has a very significant effect. This means that the high investment will increase economic growth. And further increase the employment. So the Unemployment can be reduced, and the income of the society will be increase and also the welfare of society will increase. Investment also possible to transfer the technology and knowledge from developed countries to developing countries.

The statement above means that foreign investment very has significant to the economic growth of the country like FDI(Foreign Direct Investment), because it also affects the unemployment and employment in each country to increase the labor and reduce the unemployment to reach the main goals of country that is to achieve the economic growth of the country. Foreign investors have an important

role in drive the economic, because capital formation enlarges production capacity, and also increasing the national income, which can increase employment. Foreign direct investment is one factor that drives the economic country. Foreign Direct Investment is considered more useful for the country compared to investment in company equity because of equity investment the potential for capital outflows, this equity investment is more long term short and can be withdrawn suddenly. Foreign Direct Investment starts when a company from one country invests the capital in term length to a company in another country. (Kurniawan, 2017)

Economic Development is investment support which is one of the main sources that can increase economic growth. Investment activities that constitute investment will add the capital stock. With sufficient capital stock, it will increase productivity and also the quality of production which in turn can encourage growth and increase employment. (Sulistawati, 2012)

On the other side, many governments seeing foraging direct investment FDI (Foreign Direct Investment) is one of the most has been extremely recognized as the essential way to speed up the economic growth in providing public goods and services. The presence of FDI (Foreign Direct Investment) has so many important points to accelerate developing economic growth. The most pervasive idea among researches and policymakers is that FDI (Foreign Direct Investment) enhances growth in diverse ways. Its rises the capital base and employment opportunities, it

brings technological development to local firms, which improves the productivity of the host country and stimulates economic growth. (Priya & Archana, 2016).

Beside foreign direct investment unemployment is also one of the indicators that should be pay attention, because it is also the important role to improve the social quality. Generally unemployment is people who didn't get job because of they didn't find the job and the factor that caused of the unemployment is the limitation of the job field in the regional country. However there are factor that caused the unemployment one of the factor is the limit of an education, skill, and knowledge.

Reducing unemployment and achieving high levels of economic growth is the most important priority of the economics of a developed and developing country. In terms of a country's economic success, economic growth and employment are two very important macroeconomic variables and are indispensable elements in the economic policies of many countries, especially developed countries. Because with the existence of extensive jobs accompanied by workers who can increase the productivity of a country will be able to improve the economy of a country, where a fast growing economy is very important for the welfare of a country. (Soylu, Cakmak & okur, 2018). It is undeniable that all aspects of the economy are important such as unemployment, which also has an impact on the improvement of a country's economy, where unemployment impacts poverty and also on the quality of people's life. not only that the effect of unemployment on the quality of

production where if unemployment increases it shows that the lack of workers who should produce more than a lot of goods but because of much unemployment, the production is not in accordance with what should be. In this problem, the government should build the job field that can decrease the amount of unemployment. the government should be make policy that can be decreasing the amount of unemployment. Government expenditure reflects government policy.

Government expenditure is one of the fiscal policies which is a government action to regulate the country's economy that has been determined income and expenditure every year that has been recorded in the national expenditure income budget, government spending is also one way that can be done to invest an infrastructure that can be used to economic growth and shared interests. The purpose of this government expenditure is in order to stabilize prices, output levels, and employment opportunities and stimulate or encourage economic growth. Government expenditure policy that can directly encourage economic growth is spending because this variable is realized by the development of economic and social infrastructure. (Zahari, 2017).

Al-Quran already explained about the economy, which has been widely researched today has proved that a lot of truth has been revealed in holy Al-Quran, including about economy and the forbidden things. now we can examine it on Islamic economics, where every existing knowledge in accordance with the Quran

and hadith, which is when we followed than the economy will develop and economic growth will occur. Quran says:

وَأَقِيمُوا الصَّلَاةَ وَآتُوا الزَّكَاةَ وَارْكَعُوا مَعَ الرَّاكِعِينَ

"And establish prayer, pay zakat and ruku 'along with those who bow". (Al-Baqarah: 43)

The short sentence above has broadly meaning, which explains the importance of zakat, as we know today that zakat is very important because the influence on the economic growth so BAZNAS is formed to collect and distribute zakat, infaq, alms.

Al-Qur'an says about the forbidden things in economic:

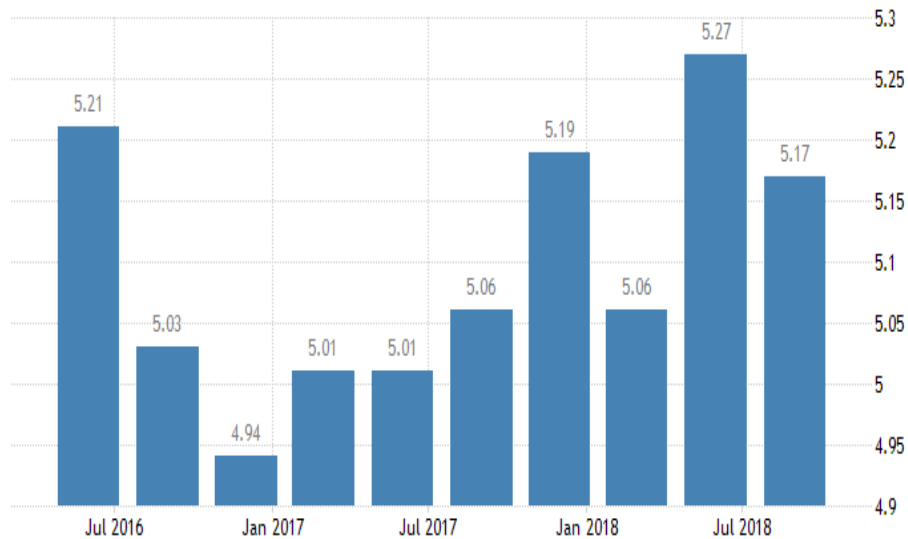
يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا الرِّبَا أَضْعَافًا مُضَاعَفَةً وَاتَّقُوا اللَّهَ لَعَلَّكُمْ تُفْلِحُونَ

"O you who believe, do not eat usury by multiplying and fear you of Allah so that you will have good luck: (Ali Imran: 130)

Where we know that, usury is very dangerous for the economy because it caused the economic crises that have a very bad impact on a country. So every what is revealed in the Quran is a truth, which has a reason why it should not be done. What already explained above show that Al-Quran is one of the commandment of ALLAH SWT that already explain about all things, included economy that already explain in al-Quran, Economics which discusses the things that should be done and should not be done in Islam is studied through Islamic economics, which explain

about all the things that forbidden in Islam, like usury (*riba*), the researches already explains about the dangerous things from usury in the economy that can be caused the economic crisis, and also inflation. From the explanation can be concluded that the Islamic economy is one of the science that studies the economic but from the Islamic perspective.

Economic growth can be measured by the increasing value of Gross Domestic Product, it's reflecting off the population welfare because Gross Domestic Product is one of the economic indicators that contain the instruments of macroeconomics that explain about the economic condition of each country and the economic growth. to find out whether the country's economy has increased or not seen from the Gross Domestic Product growth of a country, because Gross Domestic Product is an indicator that can measure a country's economic growth, with the growth of a country's economy, creating social welfare so that inequality does not occur. Indonesian Gross Domestic Product data for 2016-2018 as follows:



Source: Tredingeconomic.com/ Statistic Indonesia (2018)

FIGURE 1.1

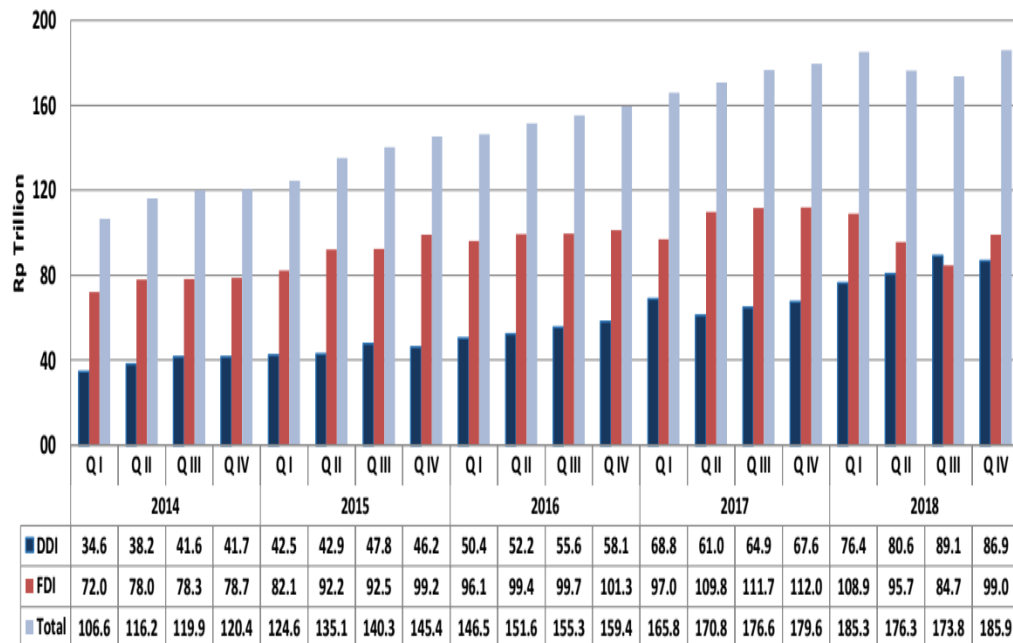
Indonesia GDP Annual Growth Percentage Data Period 2016-2018

Based on the graph of Indonesia 2016 to 2018 above show that the fluctuation of the economic growth of Indonesia. It can be seen in the graph above that the highest GDP of Indonesia is in July 2018 increased by 5.27% meanwhile the lowest is at point January 2017 decreased by 4.94%. The fluctuation of the economy is due to several factors that can effect on economic growth. It matter is means that the Indonesian economic growth from 2017 to 2018 is fluctuation.

The Indonesian economic in 2018 has a percentage of 5.27 percent, its show the sufficiency high value, compare to Indonesian economy in 2017 that has percentage 5.06 percent, it means the economy is increasing from a year. But in the

second quarter of 2018 GDP of indonesia is decreasing from 5.27 to 5.17 percent. It means the economy is decreasing from a year, because of the several factors and one of the factors is the investment slowing down. The investment has a significant impact to increase the economy. So the government should be implementing policies that are able to improve the stability of the economy.

Investment is an important factor in determining the economy growth and the economic development. With the presence of new investment, it is possible to create new capital goods so it will create new job or employment opportunities that can absorb labor, which in turn will reduce unemployment. With investment both domestic investment and Foreign Direct Investment is expected to increase the output income in a productions factor of country, which will bring the country's economy better, so that the quality of the country will be increase, which will make social welfare which means the society of the country will have better life. it can be said that Foreign Direct Investment is an important aspect to increase the economic growth of a country, because its function can be beneficial for a country, with the existence of Foreign Direct Investment the government needs to improve the quality of the country so that the country is targeted by foreign investors to invest, so that a developed country is created in various aspects. The data foreign direct investment in Indonesia period 2014-2019 are follows:



Source: The Investment Coordinating Board of the Republic of Indonesia (2018)

FIGURE 1.2

**Indonesia Foreign Direct Investment Annual Growth
Percentage Data Period 2014-2018**

Based on the graph of FDI (Foreign Direct Investment) in Indonesia years 2014 to 2018, the rate of FDI in 2017 QIV has percentage 112.0 its show the sufficiency of very high value compare to other years. Whereas in year 2018 the percent rate of FDI Q1 is 108.9 percent and QII is 95.7 percent QIII is 84.7 and the last one QIV is 99.0 percent. The data above shows the occurrence of fluctuation in the growth of

FDI as seen from the changing and unstable value. But it can be seen from 2014 to 2018 the FDI of Indonesia is decreasing from 112.0 to 99.0 percent.

FDI (foreign direct investment) plays an important role in the Indonesian economy, not only brings the capital but also the technology and marketing network, the investment direct is investment long term and can strengthen the financial system. A strong financial system will have a positive impact on increasing growth and economic stability. The stock market is an integral part of the financial system and replicas from the economic strength of a country (Panayatou, 1998).

From the above theory it is known that the important role of FDI (Foreign Direct Investment) in growth, which is shown in the graph and also theory, which explains that with FDI (Foreign Direct Investment) the economy of a country improves because it brings a development in technology and also expands the market network where a country is able to invest with foreign countries. actually foreign direct investment is no different from ordinary investment, but what distinguishes it is FDI (Foreign Direct Investment) is long term and is also able to increase international competitiveness in which investment and business people can invest in foreign companies. So that there was a marketing network, and also able to improve the development of technology in the present time is very important because of the era digitalization. Where every entrepreneur and investment is very interested in investing in technology that has an important role in today's society.

Therefore the data on economic growth and FDI (Foreign Direct Investment) growth in Indonesia from the graph above confirms the important role of FDI (Foreign Direct Investment) in promoting economic growth,

Unemployment is one of the important indicators in economic because it signifies the ability of workers to immediately find profitable employment to contribute to the productive output of the economy in a country. The highest amount of unemployment means that the total economic production will be less than what should be happened. High and continuous unemployment can signify serious difficulties in an economy and even lead to social and political upheaval. The data of unemployment in Indonesia describe as follows:

TABEL 1.1
Indonesian Unemployment Annual Percentage Data
periode 2013-2018

Total Unemployment	2013		2014		2015		2016		2017		2018	
	Feb	Aug	Feb	Aug	Feb	Aug	Feb	Aug	Feb	Aug	Feb	Aug
	5.88	6.17	5.70	5.94	5.81	6.18	5.50	5.61	5.33	5.50	5.13	5.34

Source: BPS (*Badan Pusat Statistika*) (2018)

From the Unemployment data above show that fluctuation of the unemployment rate, the highest percentage rate of an unemployment is in 2016

where the percentage is 6.18 percent, meanwhile the lowest percentage rate is in 2018 which the percentage is 5.01 percent, which means that in 2016 the unemployment is increasing, and in 2018 the unemployment is decreasing, that show the good percentage of an unemployment in 2018.

From the Unemployment data above explains that unemployment is also significant to Economic growth. Unemployment is one indicator that is impossible to eliminate but can be reduced in number. Due to many factors one of which is limited employment, unemployment is also caused by lack of human resources and supported by other factors. unemployment itself has been an economic problem from the past, because the amount is fluctuation, and also unemployment causes obstacles in the process of increasing total income and income per capita population in a country's economic structure, so that income distribution for a population will be difficult to achieve. While social unemployment has an impact on poverty. Where poverty impacts on poor social life, so Unemployment is one of the indicators that should be pay attention, because when the unemployment decreasing the in the regional of the country its shows that the economy of the country is improving. When the unemployment decreasing the quality of human life will be created, then the reduction in unemployment in a country also has an impact on reducing a country's poverty rate.

Government expenditure is one of indicator that effect economic growth of the country, government expenditure is apart of fiscal policy that plays an important role

in the country's economy, to take responsibility of the government spending and income each year, which is seen from the state budget (*APBN*). With structure of government expenditure that will help improve a country's economy. The following is the government expenditure data from 2016-2018.



Source: Tredingeconomics.com/Statistics Indonesia (2018)

FIGUR 1.3
Indonesian Government Expenditure Percentage
Data Graph Periode 2015-2018

From the graph above explain the government expenditure that has a fluctuation percentage rate. The highest government expenditure in 2018 with rate 270000, meanwhile the lowest government expenditure is in 2017 with point number 140000, which means the government expenditure increasing in 2018 showed by the quarter of 2018.

Besides Unemployment and FDI, government spending is also factor that effect economic growth, which is a part of fiscal policy that can also have significant impact on the economic growth of a country, due to government spending which is usually called the state budget (national budget planning) that has been determined every year. Government expenditure is one way the government to invest an infrastructure or things that can create jobs in order to reduce unemployment and build economic growth. with the existence of fiscal policies able to optimize natural resources (natural resources) and human resources (human resources) in a country.

Wahyuni, Sukara & Yuliarmy (as cited in Samuelson & Nordhaus, 2001) concluded that Government expenditure is the smallest relative component compared to other expenses, but the effects are quite large, both as a function of allocation, distribution, and stabilization. Government expenditure is autonomous because of the determination of the government budget is more on: The expected tax will be received, Political considerations, and Problems encountered.

That explanation was the cause of the importance of this research because the economic growth is one of the important indicators for the social welfare of the human society in the long term. Therefore to observe the factor what is the cause of economic growth itself and what is the factor effecting of the economic growth, therefore the researcher takes the title: ‘ **THE ANALYSIS IMPACT OF FOREIGN DIRECT INVESTMENT, UNEMPLOYMENT, AND**

GOVERNMENT EXPENDITURE ON ECONOMIC GROWTH IN INDONESIA PERIODE 1988-2018''.

B. Limitation of The Research

There are many factors that can affect economic growth in Indonesia, but in this study only takes a few factors. The researcher gives a limitation on the object in research where the discussion of the problem is only determined in:

1. Only focus on Indonesia's economic growth period 1988-2018
2. The object of research in the analysis of factors affecting economic growth as measured by Foreign Direct Investment, Unemployment, and Government Expenditure in Indonesia Period 1988-2018
3. The method used in this study is the VECM (vector error correction model).

C. Research Question

Based on the background that already explained about, then the problem which is going to solve in this research defined as:

1. How does the FDI (Foreign Direct Investment) effect on the economic growth in Indonesia.
2. How does the Unemployment effect on the economic growth in Indonesia.

3. How does the Government Expenditure affect the economic growth in Indonesia.

D. Research Objective

Based on the problem statement that already describes above, then the purpose of this research is:

1. To analyze the effect of FDI (Foreign Direct Investment) on economic growth in Indonesia.
2. To analyze the effect of Unemployment on economic growth in Indonesia.
3. To analyze the effect of Government Expenditure in the economic growth of Indonesia.
4. To analyze what is the most factors that affect the economic growth between Foreign Direct Investment, Government Expenditure, and unemployment.

E. Research Benefits

The existence of a study is expected to provide benefits, especially for fields in accordance with the research being studied, the benefits obtained from this study are as follows:

1. This research is expected to become input and consideration for the parties involved, especially the government in determining steps and

formulating policies related to decision making in the Indonesian economy.

2. This research is expected to be good discourse information and also knowledge for the other people who interest in the economic problem in Indonesia.
3. This research is also expected to be the reference for other research in adding the information and also for adding the materials they need about the research