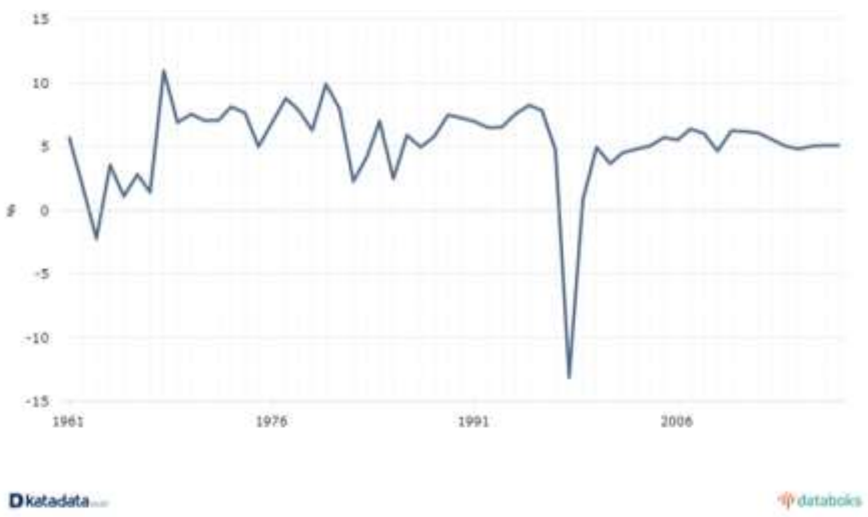
CHAPTER I

INTRODUCTION

A. Background

Economic growth is one important indicators to measure the success of development that occurs within the country (Wahyudin and Yuliadi, 2013). Economic growth is a process of increasing total income and income per capita by taking into account population growth and accompanied by fundamental changes in the economic structure of a country (Baroroh, 2012). According to Ertina (2013), economic growth is a long-term economic problem of the country towards a better condition during a certain period and can also be linked as a state of increased production capacity of an economy that is realized in the form of an increase in national income. The development of Indonesia's economic growth can be seen in the following graph data:



Source: BPS 2019 in databoks.katadata.co.id

Figure 1.1.

Indonesia's Economic Growth from 1961-2018

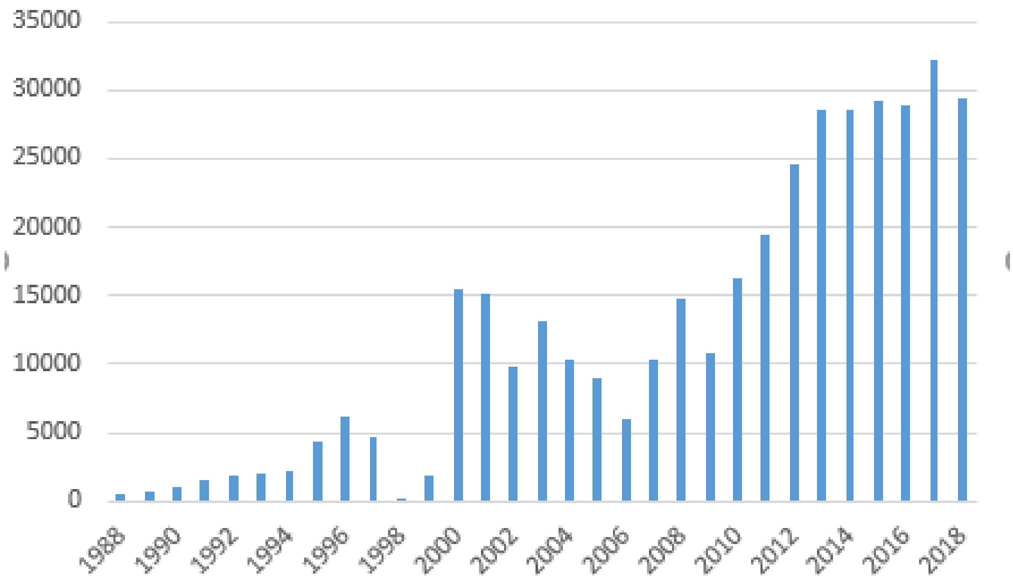
Figure 1.1. shows Indonesia's economic growth in the past 57 years. According to data released by the Central Statistics Agency (BPS), Indonesian GDP according to current prices in 2018 reached Rp 14.837,4 trillion and GDP according to constant prices grew by 5,17 Percent or Rp 10.425,3 trillion of that figure showed an increase when compared to the figures in the previous year. Increased economic growth is not spared from the success of an economic development (Pramandari, 2014), in this case Development is a series of planned to get towards a better direction.

According to Harrod-Dommar's theory of economic growth, each economy must reserve or save a portion of its national income to add or replace capital goods. To spur the process of economic growth, new investment is needed which is a net addition to capital reserves or stocks (Syahputra, 2017). Todaro (2004) in Tambunan (2015) explained that of the many factors of general economic growth it can be said that one of the main sources of economic growth is investment that can improve the quality of capital or human and physical resources, which can further improve the quality of resources through discovery new discoveries, innovations, and technological advancements.

As a developing country, Indonesia needs substantial funds to carry out national development. The large funding requirement is due to efforts to catch up with the development lags of developed countries, both in the regional and global regions. This source of FDI financing is the most potential source of foreign financing and can guarantee the continuity of development compared to other sources of financing, this is because the entry of FDI into a country is followed by a transfer of technology, know-how, management skills, relatively small business risks and more profitable, Panayotou (1998) in Sarwedi (2002). In line with research conducted by Rizky et al (2016) that partially foreign investment has a significant positive effect on economic growth in Indonesia. This means that if the value of foreign investment increases, economic growth will also increase.

The increasing investment climate in Indonesia began with the enactment of Law Number 1 of 1967 concerning Foreign Investment and Law Number 6 of 1967 concerning Domestic Investment. The enactment of the two laws has an impact on the investment climate that tends to fluctuate from year to year. The development of FDI realization in Indonesia issued by the Investment Coordinating Board shows that in 1996-2016 it tends to fluctuate. In 1997-2006 the development of FDI was not yet stable because at that time the investment climate in developing countries (Indonesia) was still experiencing disruptions. In 1996 until 1997 the development of Indonesian Foreign Investment shows depreciation, it is due to the ongoing economic crisis in Indonesia. After the crisis of the year 1999 - 2000 the investment climate experienced a sharp increase of 1.865,62 – 15.420,00 million US dollars. In 2001-2006 FDIreaslization fluctuated again.

In 2007 the Indonesian Government adopted a new Law on Foreign Investment and Domestic Investment, namely Law No. 25/2007 Article 38. The government's objective was to issue a new law, namely in the context of increasing the confidence of investors from at home and abroad .



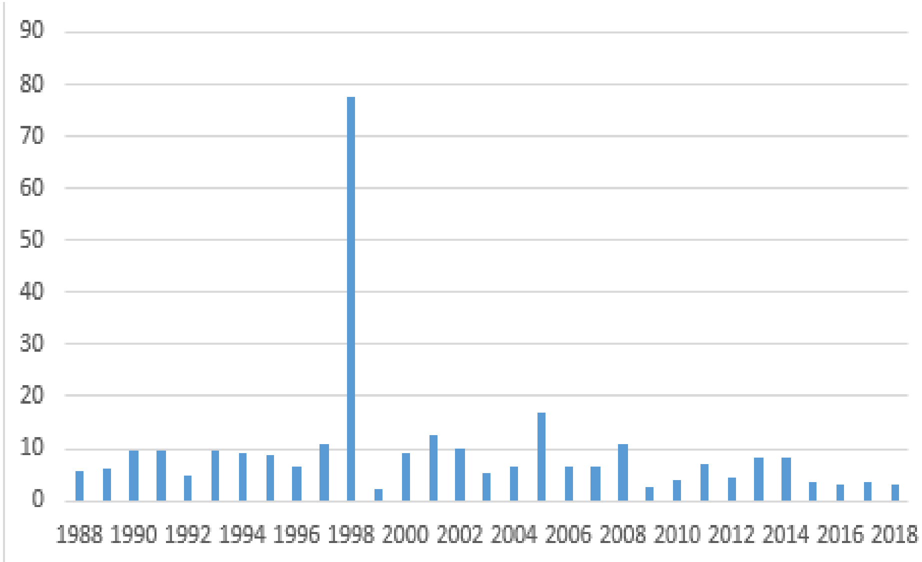
Source: World Bank 2019

Figure 1.2.

The development of FDI in Indonesia in 1988-2018

This renewal received a positive response from foreign investors, this situation is evidenced from the development of FDI for the period of 2007 to 2017 which experienced a significant increase compared to the previous period. Figures reached in the period of 2007 amounted to 10.341,40 million US dollars and experienced a large increase of 32.239,80 million US dollars. Even though in 2009 the foreign investment realization had decreased by 10.815,20 million US dollars. This happened because at that time European countries and the United States were hit by the global financial crisis in 2008 with an impact on the development of FDI in 2009. Declining FDI occurred again in 2018 and amounted to 29.307,91 million US dollars, this happened not only in Indonesia but also in global international FDI in 2018 also decreased by 20 percent.

Apart from the causes of rising and falling FDI developments, there are a number of macroeconomic indicators to advance a country's performance and potential for FDI (Kuncoro, 2009 in Septifany, 2015). Inflation is one of the factors that can influence the development of FDI.



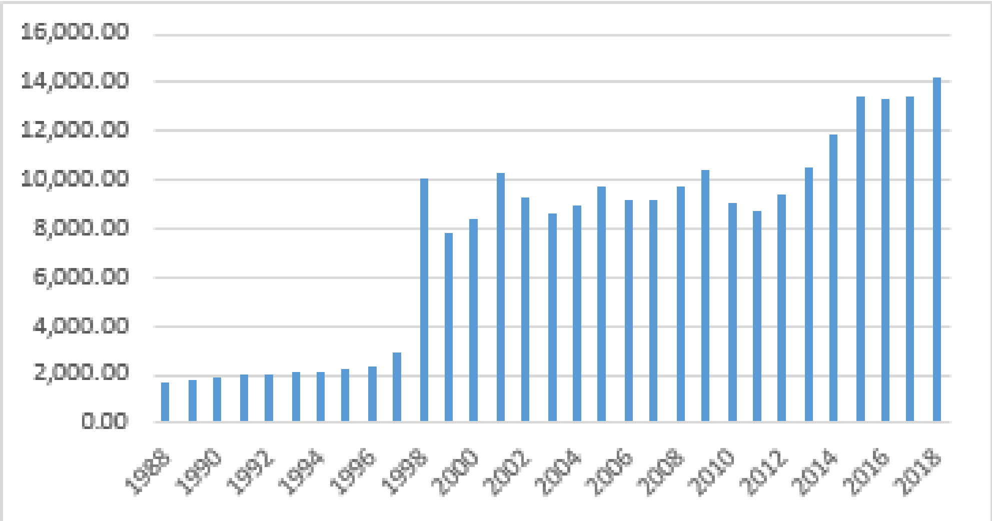
Source: world Bank 2019

Figure 1.3.

The development Indonesia's Inflation 1988-2018

The highest increase in inflation experienced by Indonesia was 77,63 percent, the increase was due to the monetary crisis experienced by Indonesia in 1988. Tandelin (2010) in Rachmawati and Laila (2015) said if inflation had a negative impact on capital owners or investors in the capital market . This is in line with research conducted by Septifany et al (2015), namely inflation has a significant negative effect on Foreign Investment, which means that if the country with a high inflation rate will reduce the desire of people to consume, so investors are not interested to invest in the country.

Interest rates in the future is an important consideration before investing. Bank loans are one source of funds obtained by investors in providing investment costs. Research conducted by Dewi and Triaryani (2015) concluded that the interest rate variable had a negative and significant impact on FDI, so when the interest rates prevailing in a country were higher the investor's desire for beer investment was smaller. To prosper the society, dynamic economic growth is needed, namely the situation where the Gross Domestic Product (GDP) increases. In a study conducted by Fadilah (2017), it states that the GDP variable has a positive and significant effect on foreign investment in Indonesia, this means that when national income is high, investment will increase.



Source : World Bank 2019

Figure 1.4.

The Exchange Rate of Indonesia 1988-2018

The development of the Indonesian exchange rate from 1988 to 2018 continued to fluctuate, in 2009 the rupiah exchange rate was in the position of Rp 10.389,94 and in 2013 to 2018 the rupiah exchange rate fell to Rp 14.236,94.

Knowledge of the exchange rate of a currency will help us in assessing the prices of goods and services obtained from several countries (Tambunan, 2015). Research conducted by Pratiwi et al (2015) concluded that the exchange rate variable has a negative and not significant effect. means that exchange rates or fluctuating and volatile exchange rates will make a country's economic situation worsen so that foreign investors no longer invest their capital in that country.

Islamic economic activities are very supportive of investment activities, because in Islamic teachings the resources (assets) that are owned are not only to be saved but must be productive in order to bring benefits to others. This is based on the word of Allah SWT:

كَيْ لَا يَكُونَ دُولَةًۢ بَيْنَ ٱلْأَغْنِيَآءِ مِنكُمْ ۚ

"So that the treasure does not circulate among rich people only among you". (Surah al-Hashr (59): 7).

The investment according to the Qur'an contained in the QS. Al-Baqarah [2]: 261

مَثَلُ الَّذِينَ يُنْفِقُونَ أَمْوَالَهُمْ فِي سَبِيلِ اللَّهِ كَمَثَلِ حَبَّةٍ أَنْبَتَتْ
سَبْعَ سَنَابِلَ فِي كُلِّ سُنْبُلَةٍ مِائَةُ حَبَّةٍ ۗ وَاللَّهُ يُضَاعِفُ لِمَنْ
يَشَاءُ ۗ وَاللَّهُ وَاسِعٌ عَلِيم

"The parable of those who spend their wealth in the way of Allah is similar to a seed that grows seven ears, in each one hundred seeds. Allah multiplies (rewards) for whom He wills. And Allah is vast (His gift) is All-knowing "

This verse explains the importance of investing, where this verse conveys how lucky people are to spend their wealth in the way of Allah. People who are financially wealthy (financial) then invest their wealth to empower underprivileged people with productive businesses, then in fact he has helped thousands or evenhundreds of thousands of people who are unable to have a positive attitude towards it.

From the background description above, making the writer motivated to conduct research in the form of the influence of interest rates, exchange rates, inflation and GDP on Foreign Direct Investment (FDI) in Indonesia. The author hopes that this research can add insight to researchers and readers about Foreign Direct Investment as well as what variables affect it. From the explanation above, the researcher took the title **"Analysis The Influence of Interest Rates, Exchange Rate, Inflation and Gross Domestic Product to Foreign Direct Investment (FDI) in Indonesia Period 1988-2018".**

B. Formulation of the Problem

Based on the background explanation above, the author hereby formulates the problem to be examined, namely:

1. How is the influence of Interest Rates on Foreign Direct Investment (FDI) in Indonesia?
2. How is the influence of the Rupiah Exchange Rate on Foreign Direct Investment (FDI) in Indonesia?.
3. How is the influence of Inflation on Foreign Direct Investment (FDI) in Indonesia?.
4. How is the influence of GDP on Foreign Direct Investment (FDI) in Indonesia?.

C. Purpose of the Research

The objectives of this research are as follows :

1. To analyze the influence of Interest Rates on Foreign Direct Investment (FDI) in Indonesia.
2. To analyze the influence of the Rupiah Exchange Rate on Foreign Direct Investment (FDI) in Indonesia.
3. To analyze the influence of Inflation on Foreign Direct Investment (FDI) in Indonesia.

4. To analyze the influence of GDP on Foreign Direct Investment (FDI) in Indonesia.

D. Benefits of the Research

A research was conducted in hope that this research could give a benefit for others and for the authors themselves. This result is expected to provide benefits in various ways, including:

1. The results of this study are expected to provide a picture of how the influence of Interest Rates, Exchange Rates, Inflation and GDP on Foreign Investment (FDI) in Indonesia.
2. The result of this study are expected to be able to provide input for the government in implementing the policies that will be carried out in the future.
3. The result of this study can be as a reference for further research