CHAPTER I

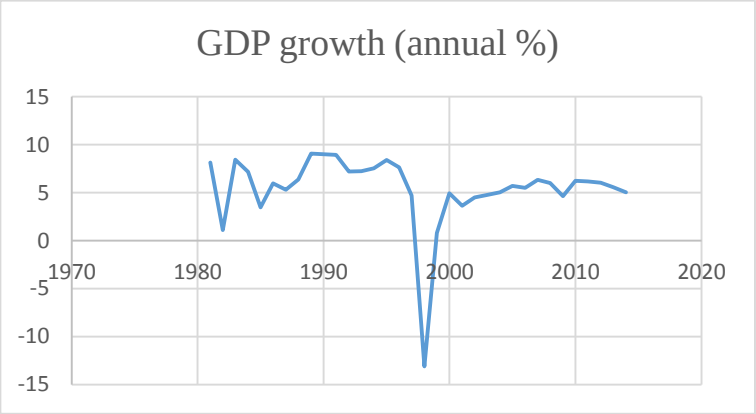
INTRODUCTION

A. Research Background

Economic performance is an assessment of its success in areas related to its assets, liabilities and overall market strength. Many countries take regular stock in either formal or less formal basis of the general economic performance of their countries to make sure that it remains on the right track financially. Economic performance can be seen from economic growth. Economic growth is an indicator to perceive a country's performance whether in good or bad performance. The success of the development of a country can be seen from the level of economic growth. Therefore, each country always set target of high economic growth rates in the planning and development objectives. By high sustainable economic growth means as the main condition for sustainable development economy.

In the narrow sense, economic growth means the increase in total production of both goods and services. This is measured by the change in real gross domestic product (GDP) and by the change of real gross domestic product per capita. GDP is the total value of all final goods and services produce in a country in a one-year period. The value of GDP would give a view of how a country's ability to manage and utilizing existing resources.

Indonesia is one of the developing countries in the world. As a developing country Indonesia has been joined as a member in G-20 major economies and classified as the newly industrialized country. Based on the data from world-bank in 2013, the gross domestic product of Indonesia reached 3,475.25 USD. Indonesia experienced a GDP growth of 5.8% per 2013, it is of course a good hope for the Indonesian's government to realize the improvement of people's welfare.



Source: World Bank

FIGURE 1.1

The Annual GDP Growth in Indonesia

The graph above explained about the development of economic growth in Indonesia for 34 years from 1981 until 2014. Given the fact from World Bank, it can be concluded that the economic growth in Indonesia moving into

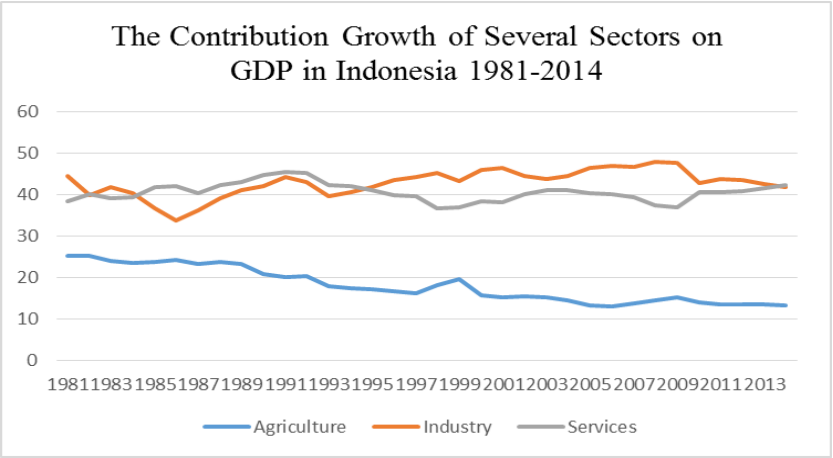
fluctuation ways for 34 years. In the crisis 1998, the economic growth in Indonesia decreased dramatically around -13.12%. As for Indonesia, the main cause of financial crisis happens because of the internal source at that time. The crisis started when huge capital flight out from Indonesia. The direct result of capital flight that occurred in Indonesia, result in Indonesia's national currency (rupiah) then deteriorated against the US dollar. Moreover, many companies bankrupted and the national banking sector collapsed (Tambunan T. , 2010).

Indonesia has suffered a crisis in 12 years, for example, in 1997/1998 and 2008/2009. Because of those crises, Indonesia economy is exposed to economic shocks, either from internal sources or external sources, for the following main reasons. Firstly, Indonesia's economy becomes more open to other countries. Therefore, any volatility which happens in global economics will effect on Indonesian economic as well. Secondly, Indonesia is still depend on the primary commodities, especially agriculture sector. So when, the price instability happens in the primary commodities, became a shock for Indonesian economy. Thirdly, because of the instability of these commodities, it is also impact the domestic consumption and food security in Indonesia (Tambunan T. , 2010).

In fact, economic growth in a country cannot be separated from the role of government from policy makers both fiscal and monetary, and the role of society as a source of investment and production factors in running a country's

economic cycle. Hence, gross domestic product has become a measure of the ability of a society to produce a product that can enhance the economic growth of a country.

One of the important things by using of national income data is to determine the rate of economic growth which is achieved by a country year to year. Data from national income can also be an indicator to see the economic performance. By observing the growth of a country from year to year, it can be assessed achievements and success in controlling the country's economic activity in the short term and in the long term. Comparisons may also be made between the level of the country's success in controlling and build its economy achieved when compared with other countries. (sukirno, 2013)



Source: World Bank

FIGURE 1.2

The Contribution Growth of Several Sectors on GDP in Indonesia 1981- 2014

Gross domestic product cannot be separated from that contributions given by various sectors produced in Indonesia. With an area of 1,905 million km which is owned by Indonesia, there are a wide variety of sectors contributing. The figure 1.2 above shows the development contribution of several sectors on gross domestic product in Indonesia.

The income which is gained by the government come from three major sectors; agriculture, industry, and services. The development of the three sectors fluctuates for 34 years. The highest contributing sector is industry, followed by service, and the last is agriculture. The agriculture sector trend tends to decrease each tear although it once increases after the Asian crisis in 1997. The previous contribution is 16% increased to 19% after the crisis. In the beginning of 1995, the industry sector surpassed the service sector until 2014; while since 1981 to 1995 the service sector contributed the most to the national income

In macroeconomic analysis, besides explaining the supporting factor that possibly affect the economic growth, it also discusses on the issues such as; inflation. Inflation is a process of rising prices in general and continuous (continuous) for a certain time. In other words, inflation is also a process in which the declining in currency values continuously. Inflation is a process of an event, not the high-low level of a price. That is, if the high price level it has not conclusively point to inflation. If a process of price increase continues to

happen and influence each other means there is inflation. To achieve sustainable economic growth along with price stability continues to be the main objective of economic policy macro to most countries in the world today.

Based on the data from World Bank, the rate of inflation in Indonesia has fluctuated over the time. The highest level of inflation is happen when Asia financial crisis in 1997. Because of that problem, the inflation rate reach 58.3% and 20.48% in 1999. It became the hardest-hit country because the crisis not only had economic but also significant and far-reaching political and social implications. And after that, the inflation rate in Indonesia gradually back to normal.

There are three main components in the growth for each country, namely capital accumulation, population growth, and technological advances. As discussed above, the economic growth associated with the state's ability to produce goods and services and the increase in per capita income of the population. The accumulation of capital is reinvested earnings with the aim to increase output (Todaro, 2000).

In this globalization era, foreign direct Investment (FDI) plays an important role in international business. Economic integration occurs between the countries in the world encourage the emergence of cooperation in the economic, political, social and cultural. As the developing country in the world, Indonesia requires substantial funds in implementing national development. It

is due to the undertakings in pursuit of the underdevelopment of the developed countries in the world globally. The fact that Indonesia itself is not able to provide the fund for development itself.

The sources of financing in development could come from domestic and abroad. One of the external types of is Foreign Direct Investment (FDI). According to (Panayotou, 1998) in (Sarwedi, 2002) tells that FDI is more important to ensure the continuing development in a country compared to other funding streams such as, portfolio, because the presence of FDI will be followed by the transfer of technology, know-how, management skills, business risk is relatively smaller and productive (Sarwedi, 2002).

According to Jhingan (2004) In Agma tells that foreign investment in the need to build economic acceleration. This is because the foreign capital can help in the process of industrialization in order to create wider opportunities. Foreign capital could be aid technology.

Foreign investment in Indonesia, has become a funding source that can be used as financing for development and economic growth. By using foreign investment, it is intended to replace the use of foreign debt as a source of financing. Because with the increasing uncontrolled interest rates on foreign debt and the rupiah exchange rate against foreign currencies make Indonesia will decrease the difficulties in the repayment of the debt.

Based on the legal basis, Foreign Direct Investment has been regulated by UU No.1 year 1967 and UU No.11 year 1979. In this basis, FDI means that foreign investment activities directly undertaken by or under the provisions of this law and used to run a company in Indonesia, and the owners of the capital directly bear the risk of the investment.

The realizations of foreign direct investment in every country fluctuate every time. The following data is the development net inflows of FDI in Indonesia among the other ASEAN-4-Nations based on the World Bank from 2011 until 2014 in Million US Dollar:

TABLE 1.1

The Foreign Direct Investment from 4-Asean-Nation (in Million US Dollar)

	Year			
	2011	**2012**	**2013**	**2014**
Indonesia	20,564,938,227	21,200,778,608	23,281,742,362	26,277,377,236
Thailand	2,468,144,240	12,894,549,139	15,822,132,057	3,718,726,247
Malaysia	15,119,371,191	889,577,425	11,296,278,696	10,619,431,770
Philippines	2,007,150,725	3,215,415,155	3,737,371,740	5,739,574,024

Source: World Bank

Based on the table above, Indonesia has become the largest foreign direct investment realization among the ASEAN-4-Nations. The realization of

foreign direct investment (net-inflows) in Indonesia always increase from 2011 until 2014. Similarly, the net inflows of FDI always increase over 4 years in Philippines. On the contrary, the foreign direct investment of the other countries fluctuates at that time. Surprisingly, for 4 years, the FDI of Malaysia decreased on 2012, and keep increasing in 2013 and 2014. The smallest foreign direct investment is Thailand among ASEAN-4-Nations.

Investors invest in Indonesia with various forms. Usually investors come to a province or region that have advanced development. This is because of the stability that the investors can have from that advanced province. Province in Java Island mostly become the choice from the investors to be the right place to invest. The difficulty is that not every province has the same growth and stability. So, there is the amount gap in each province.

Indonesia is an archipelago with many islands and is divided into 34 provinces. The investments that are in Indonesia are scattered throughout the area in Indonesia. Each province has its uniqueness to offer to investments. Indonesia is rich with the natural resources, so that the investors can choose to invest on this development. There are various types of industries in Indonesia that the investors can also choose. The following is an overview of the distribution of foreign direct investments in each region in Indonesia taken from the Investment Coordinating Board of the Republic of Indonesia in January-December2014:

TABLE 1.2

The Foreign Direct Investment by Province in Indonesia in 2014

NO	PROVINCES	INVESTMENT (US$/Million)	Project
1	West Java	6,561.90	1,671
2	Special Teritory of Jakarta	4,509.40	3,053
3	East Kalimantan	2,145.70	191
4	Banten	2,034.60	709
5	East Java	1,802.50	497
6	Central Sulawesi	1,494.20	58
7	Riau	1,369.60	129
8	Papua	1,260.60	42
9	South Sumatra	1,056.50	114
10	West Kalimantan	966.1	158
11	Central Kalimantan	951	126
12	West Nusa Tenggara	551.1	167
13	North Sumatra	550.8	249
14	South Kalimantan	502.5	78
15	Central Java	463.4	224
16	Bali	427.2	582
17	Riau Islands	392.1	128
18	South Sulawesi	280.9	58
19	Southeast Sulawesi	161.8	77
20	Lampung	156.5	50
21	West Papua	153.3	42
22	West Sumatra	112.1	72
23	North Kalimantan	108.3	18
24	Bangka Belitung Islands	105	34
25	North Maluku	98.7	23
26	North Sulawesi	98.5	69
27	Special Region of Yogyakarta	64.9	48
28	Jambi	51.4	42
29	Aceh	31.1	49
30	Bengkulu	19.3	17
31	West Sulawesi	16.2	7
32	East Nusa Tenggara	15.1	57
33	Maluku	13.1	33
34	Gorontolo	4.1	13

Source: The Investment Coordinating Board Indonesia (BKPM)

The table 1.2 above explains about the foreign direct investment based on the locations in Million US Dollar and the total project for each location. According the table above, in January- December period, the highest realization of FDI was located in West Java with the total Investment 6,561.9 Million US Dollar. On the other hand, the lowest realization of FDI was located in Gorontalo with the total investment only 4.1 Million US Dollar. Besides the total investment, the highest number of the total project was located in Special Territory of Jakarta with 3,053 project in 4,509.4 Million US Dollar total investment. At last, the lowest total project was located in West Sulawesi with only 7 project in 2014.As we have discuss previously, the size of the economic growth in each country, depending on the capital invested by each country. The need for productive investments in supporting social and economic necessity to carry out the process of development in a country

Beside investments, Export also play an important role in the economic activities of a country. Exports will generate income that will be used to finance imports of raw materials and capital goods needed in the production process that will create value-added. Aggregation value added generated by all production units in the economy is the value of products GDP (Sutawijaya & Zulfahmi, 2010).

TABLE 1.3

The Export and Import Growth in Indonesia in Million US$

Year	Export	Import
2009	116510	96829.2
2010	157779.1	135663.3
2011	203496.6	177435.6
2012	190020.3	191689.5
2013	182551.8	186628.7
2014	175980	178178.8

Source: World Bank

Net exports is the difference between the value of goods and services export to other countries for goods and services imported from other countries. In this case, exports in Indonesia has fluctuated in the last 6 years. From the table 1.3 above, it conclude that the total import is greater than the total export in Indonesia. It means that the directions net export growth rate of Indonesia are in a negative direction within the last 6 years.

Through productivity gains, from the micro level, infrastructure can promote economic growth. Kuznets in his theory mentioned that the economic growth of a country is affected by the accumulation of capital, natural resources, human resources, with a view of quantity and quality. On the other hand, infrastructure can be categorized as capital accumulation. So, infrastructure can be used as inputs to production indirectly.

The developing countries has made an investment of 200 billion US dollars each year for the construction of the new infrastructure (World Bank, 1994). With the investments were acquired, the expected increase value of infrastructure will be better in the future, in fact sometimes the performance of infrastructure is disappointing. One of the causes is an error in the allocation of funds. For example, the development of infrastructure continued without maintaining the existing infrastructure.

The effort to revamp the infrastructure conditions to realize an important role in reducing inequalities of income and long-term effects for gross domestic product is important. Improvements in infrastructure have contributed to increasing productivity and is expected to support economic growth in the long term (Maryaningsih, Hermansyah, & Savitri, 2014)

In this research, it focuses on the long road infrastructure in Indonesia in Kilometer units. By having the best quantity and quality road infrastructure in Indonesia, country will able to provide convenience in the distribution of economic activities in the community. Based on World Bank in 2013, Roads are the main transport in Indonesia, and the total road network recorded more than 477,000 km with an asset value of more than 15% of GDP. However, the number and quality of road infrastructure in Indonesia is still below neighboring countries. The Indonesian government has increased infrastructure spending

way to 70 trillion Rupiah per year (USD 7 billion per year), representing 40% of total spending on infrastructure.

However, the level of investment of this magnitude cannot pursue increased demand and growth in the last ten years. Productivity and efficiency management of national roads are still less than optimal. The spending of national roads has tripled in real terms between 2005 and 2011, but output which is generated in the road length only rose 20% whether if counted from the existing road or the road under construction.

With the progress that has been achieved, Indonesia still has to face the problems that are faced by other countries, especially developing countries, who are on development. The process of economic performance is affected by two kinds of factors, namely, economic factors and non-economic factors.

Based on the terms describe above, the need for scientific assessments of the factors that affecting economic growth in Indonesia is highly needed. In this case the factors that will be analyzed are the factors in economic which are foreign direct investment, export, infrastructure, and inflation rate.

B. Research Limitation

This research only limit in Foreign Direct Investment, Export and Infrastructure especially in Road Length (in Km^2), and Inflation Rate on Economic Growth (GDP) in 1981 until 2014.

C. Research Questions

Based on the background, the researcher needs to formulate the problem as the ultimate goals of this research which includes:

1. What is the impact of foreign direct investment on economic growth in Indonesia in short and long run?
2. What is the impact of export on economic growth in Indonesia in short run and long run?
3. What is the impact of infrastructure on economic growth in Indonesia in short and long run?
4. What is the impact of inflation on economic growth in Indonesia in short and long run?

D. Research Objectives

Based on the research questions, thus the objectives of this paper are:

1. In order to know about the impact of foreign direct investment on economic growth in Indonesia in short and long run.
2. In order to know about the impact of export on economic growth in Indonesia in short and long run.
3. In order to know about the impact of Infrastructure on economic growth in Indonesia in short and long run.
4. In order to know about the impact of Inflation on economic growth in Indonesia in short and long run.

E. Research Benefits

This study contributes useful information for parties which are interested in Economic performance in Indonesia. The detailed of research objectives will be explained below:

1. It can help to explain about the impact of foreign direct investment, export, Infrastructure, and Inflation on economic growth in period 1981-2014.
2. It can help to increase the knowledge, experience, and as a place to practice and apply science sciences knowledge has been gained while studying on campus.
3. It is expected could be input analysis and comparison for the other researchers.