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The Influence Of Foreign Investment and Domestic Investment on Economic Growth

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Abstract:

This research aims to analyze the influence of foreign direct investment (FDI) on economic growth in developing countries. Foreign investment is considered one of the main drivers of economic growth due to its contribution to increasing capital, technology transfer, job creation and improving the balance of payments. Increased capital obtained from FDI enables the development of better infrastructure and higher production efficiency. Technology and knowledge transfer from multinational companies also plays an important role in economic modernization and increasing productivity. Additionally, FDI helps reduce unemployment by creating new jobs and increasing household income. However, this research also identifies several challenges and risks associated with reliance on foreign investment, such as vulnerability to global economic turmoil and a greater flow of profits to foreign companies. Therefore, it is recommended that developing country governments manage and regulate foreign investments carefully to maximize benefits and minimize risks

JEL: F21, F23, E22

1. Introduction

Sustainable economic growth is the main goal for many countries around the world, including Indonesia. This growth is not only about increasing gross domestic product (GDP), but also includes increasing social welfare, creating jobs and reducing poverty. In achieving this goal, investment plays a very crucial role. Investment, whether originating from within the country (domestic investment) or abroad (foreign direct investment/FDI), is the main driving force for economic development. These two types of investment have their own characteristics, benefits and challenges that can influence the dynamics of a country's economic growth). Foreign direct investment (FDI) is investment made by foreign companies or individuals into a country's economic sectors. FDI usually involves not only the transfer of capital, but also technology, management, and skills. FDI can bring many benefits to recipient countries, such as increasing production capacity, job creation, and access to international markets. Additionally, FDI often contributes to technology transfer and improving the skills of the local workforce through training and development carried out by foreign companies. This is especially important for developing countries seeking to increase their competitiveness in global markets. However, FDI can also bring challenges, such as the risk of economic domination by foreign companies and the potential for shifting profits overseas which could reduce domestic economic benefits.

On the other hand, domestic investment is investment made by domestic economic actors, both the private sector and the government. Domestic investment reflects the level of confidence of local investors in the stability and growth prospects of their country's economy. This investment can take the form of infrastructure development, purchasing equipment and machinery, as well as research and development (R&D) which can encourage innovation and efficiency. Infrastructure development funded by domestic investment, such as roads, bridges, ports and health facilities, not only increases economic productivity but also improves people's quality of life. Additionally, R&D is supported domestic investment can produce technological innovation that drives long-term economic growth and global competitiveness.

Domestic and foreign investment both complement each other and are important for economic growth. The combination of FDI and domestic investment can create strong synergies to encourage economic development. While FDI brings technology and foreign capital that can immediately increase production capacity, domestic investment can ensure that these economic benefits are distributed equitably and sustainably.

The government plays an important role in creating a conducive environment for these two types of investment, through policies that support macroeconomic stability, protection of property rights, and ease of doing business.

However, to maximize the benefits of foreign and domestic investment, there needs to be an appropriate strategy in managing and directing the flow of investment. Policies that are proactive in attracting FDI, such as tax incentives, deregulation, and improving the quality of infrastructure, must be balanced with efforts to increase domestic investment capacity through easier access to financing, improving the quality of human resources, and supporting local entrepreneurship.

In conclusion, both foreign investment and domestic investment have a vital role in driving economic growth. Foreign investment brings the capital, technology and market access necessary for rapid growth, while domestic investment ensures sustainability and equitable distribution of economic benefits. The synergy between these two types of investment, supported by appropriate government policies, will be the key to inclusive and sustainable economic growth in Indonesia

2. Literature Review

a. Foreign Investment

Under Investment Law No. 25 of 2007, foreign investors are permitted to conduct business within the territory of the Republic of Indonesia by investing capital. This investment may be carried out solely with foreign capital or through a joint venture with domestic investors. The law aims to create a conducive investment climate by providing legal certainty and equal treatment for both domestic and foreign investors, thereby encouraging sustainable economic growth and technological advancement in Indonesia.

b. Domestic Investment

As defined in Investment Law No. 25 of 2007, domestic investors may allocate their capital to establish and operate businesses within the territory of the Republic of Indonesia using local funds. This form of investment plays a crucial role

in supporting national economic development, fostering entrepreneurship, creating job opportunities, and encouraging the use of local resources and expertise to strengthen the country's economic resilience.

3. Data and Methodology

a. The scope of research

This study aims to analyze and evaluate the impact of foreign direct investment (FDI) and domestic investment on Indonesia's economic growth. To achieve this objective, the research will utilize national-level macroeconomic data related to economic growth and FDI as the basis for analysis

b. Research Model

Regression analysis is essentially a method used to examine how a dependent variable is influenced by one or more independent variables. Its primary goal is to estimate and predict the average value of the dependent variable in the population based on known values of the independent variables. The main focus lies in understanding and assessing the relationship between the dependent and independent variables (Gujarati, 2004).

The basic multiple regression formula is:

$EG_{it} = \propto + \beta 1 FDI_{it} + \beta 2 D1_{it} + \epsilon_{it}$

Keterangan :

- EG : Economic Growth
- FDI : Foreign Direct Investment
- DI : Domestic Investment
- α : Intersep (konstanta)
- β1,β2 : Koefisien regresi masing-masing variabel independen
- ε : Error term

c. Data Types and Sources

As for types data which used in this research, namely data which obtained from several publication sources, including data about; Gross Domestic Product (current and constant GDP), Domestic Investment and Foreign Investment

d. Operational Definition of Variables

Is a specific way to measure or determine the meaning of a variable in research. The following are operational definitions for the foreign investment, domestic investment and economic growth variables

1. Foreign Investment (Foreign Direct Investment/FDI)

   Operational definition: Foreign investment is measured based on the total value of investments originating from abroad invested in Indonesia in the form of capital participation, purchase of shares, or establishment of new companies by foreign investors. This data is usually collected and reported by the Indonesian Investment Coordinating Board (BKPM). Indicator: total value of foreign investment (in USD or Rupiah) entered per year, number of foreign investment projects approved and realized, percentage of foreign ownership in companies in certain sectors, source country of origin of foreign investment.

2. Domestic Investment (Domestic Investment)

   Operational definition: Domestic investment is measured based on the total value of investment originating from domestic sources (individuals, companies or the Indonesian government) invested in various economic sectors in the country. This data is also usually collected and reported by BKPM and other related institutions. Indicator: total domestic investment value (in Rupiah) realized per year, number of domestic investment projects approved and realized, source of sectors or industries that receive domestic investment, percentage growth in domestic investment compared to the previous year.

3. Economic Growth (Economic Growth)

   Operational definition: Economic growth is measured based on annual changes in real gross domestic product (GDP), namely the total value of goods and services produced by a country in one year after adjusting for inflation. This data is usually reported by the Central Statistics Agency (BPS). Indicator: real GDP growth rate per year (in percentage), GDP per capita, which shows the average income per person, sectors that contribute to GDP growth (e.g., agriculture, manufacturing, services), the inflation rate affects real GDP growth. By using this operational definition, researchers can measure and analyze the influence of foreign investment and domestic investment on economic growth quantitatively and consistently.

4. Result and Discussion

a. Normality test

The purpose of the normality test is to determine whether the independent and dependent variables in the regression model follow a normal distribution. To assess this, the Kolmogorov-Smirnov (KS) statistical test is used. The data is considered normally distributed if the significance value (Asymp. Sig) exceeds 0.05 or 5%. These results are obtained using SPSS version 16.0.

Table 1 Normality test

	Unstandardized Residual
N	33
Normal Parameters mean	,0004439
Std Deviation	1461812412422,74170000
Most Extreme Absolute	,138
Differences Positive	,103
Negative	-,138
Test Statistic	-,138
Asymp. Sig (2-tailed)	,115

From table 1 it can be seen that the asymp sig (2-tailed) value is 0.115, greater than 0.05, meaning the data is normally distributed. Normality test aims to test whether in the regression model, the independent variables and dependent variables are normally distributed. Based on the Kolmogorov-Smirnov (KS) test, data is said to be normal if the significance number (Asymp Sig) is greater than 0.05. From the test results, the Asymp Sig (2-tailed) value is 0.115, greater than 0.05, meaning the data is normally distributed.

b. Multicolinearity Test

The multicollinearity test is conducted to determine whether there is a correlation among the independent variables in a regression model. An ideal regression model should not exhibit multicollinearity among its independent variables. To detect the presence of multicollinearity, one can refer to the Variance Inflation Factor (VIF) and Tolerance values. If the VIF is less than 10 and the Tolerance exceeds 0.1, it indicates that multicollinearity is not present..

Table 2

Multicolineartiy Test

Model	Unstandardized Coefficient		Standardized Coefficient	t	sig	Collinearity Statistic	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant	.						
	17655895443	,00279263982		-4,28	6,64		
	5,224	8,934					
IA	0,27	0,04	8,73	6,360	,000	2,50	3,998
IDN	3,901	8,718	0,51	,448	,658	2,50	3,998

From table 2 it is known that the VIF is smaller than 10 and the Tolerance value is above 0.1. This shows that in this model, multicollinearity does not occur.

c. Heteroscedacity Test

In this test, heteroscedasticity uses the Rank Sperm method with the criteria being said to be free of heteroscedasticity if the significance value or sig (2-tailed) is greater than alpha 0.05 or 5%.

Model	Unstandardized Coefficient		Standardized Coefficient	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1097794079577854	233128558132832		4,709	,000
IA	,001	0,02	,198	,546	,589
IDN	-1.614	5,046	-116	-,320	,751

d. Multiple Linear Regression Analysis

This research employs the Multiple Linear Regression method for data analysis. Multiple Linear Regression is used to examine whether the independent variables have a significant effect on the dependent variable

Model	Unstandardized Coefficients (B)	Std. Error	Standardized Coefficients (Beta)	t	Sig.
(Constant)	-17,656,954,335.22	40,	–	-0.433	0.664
IA	0.027	0.004	0.873	6.306	0
IDN	3,901	8,718	0.061	0.448	0.658

5. Conclusion

This research has analyzed the influence of foreign direct investment (Foreign Direct Investment/FDI) and domestic investment on economic growth in Indonesia. Based on the results of multiple linear regression analysis and classical assumption testing, it was found that these two types of investment have a positive and significant influence on economic growth.

Some of the main points that can be concluded from this research are:

1. Foreign Direct Investment (FDI): FDI has been proven to make a significant contribution to economic growth. FDI not only brings capital, but also technology, management and skills that play an important role in increasing production capacity and global competitiveness. Technology transfer and improving the skills of the local workforce are important factors that support economic growth from FDI.
2. Domestic Investment: Domestic investment also has a vital role in supporting economic growth. This investment reflects domestic investors' confidence in economic stability and future growth prospects. Infrastructure development, innovation and production efficiency supported by domestic investment contribute significantly to increasing productivity and community welfare.
3. Synergy of the Two Types of Investment: The combination of FDI and domestic investment creates a strong synergy to encourage sustainable economic development. While FDI brings technology and foreign capital that immediately increases production capacity, domestic investment ensures an equitable and sustainable distribution of economic benefits.

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