Research Paper

Indonesia's FDI in Development of Special Economic Zones (SEZs)

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Abstract.
In realizing equitable development and economic growth, it is necessary to develop special economic zones (SEZs) as a form of commitment of the Indonesian government; and if viewed from the budget perspective applied, it is still limited. This study aims to determine the factors affecting Foreign Direct Investment (FDI) in Indonesia from 2008 2nd quarter to 2021 2nd quarter. Based on that period, the economy in Indonesia experienced a contraction since the Asian monetary crisis in 1998. So that the development of SEZs experienced financial budget constraints and Indonesia can try to find other financing solutions. For developing countries, such initiatives should be taken in order to attract foreign investment. This study uses quantitative research with the analytical method used is the Vector Error Correction Model (VECM), which is a derivative of the vector autoregressive (VAR) method. The results of this study indicate that for the long-term VECM variable estimates only interest rates have a negative effect on FDI, and trade inhibition, inflation, and GDP variables have a positive effect. While the wage variable has no effect on FDI. In this phenomenon, it is necessary to pay attention first to the influence on FDI, companies in Indonesia, the majority of which are labor-intensive workers.

Keywords: FDI, GDP, inflation, interest rates, trade inhibition, wage

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1. Introduction

The establishment of Special Economic Zones (SEZ) is a demonstration of the Indonesian government's commitment to fostering regional economic development and equity. However, in order to get there, the government must contend with the fact that its budget is constrained. As a result, efforts must be made to identify alternate sources of funding for the project. Therefore, it is anticipated that the presence of foreign direct investment (FDI) will make up the budgetary imbalance. FDI serves as more than just a source of funding. In particular, according to (Huong et al., 2020). FDI helps developing nations transfer technology, generate new jobs, and give employees access to new, more contemporary knowledge and skills. As a result, efforts to draw in foreign investment will benefit the economy.

Indonesia is among a group of nations in the ASEAN that receive significant FDI capital flows. Over the past ten years, Indonesia has continuously ranked second to Singapore as the country receiving the most FDI. However, when compared to other nations in the region, Indonesia comes in last when looking at the ratio of FDI flows to gross domestic product (GDP). The evolution of FDI capital flows in ASEAN during the previous ten years is seen in Table 1.

Table 1: Development of ASEAN FDI Flows, 2010-2020.

Country	In million US$				Percentage of GDP *)			
	2010	2015	2020	Average	2010	2015	2019	Average**)
Brunei	625,4	171,3	577,4	540,2	3,51	1,32	2,77	2,98
Kamboja	782,6	1.701,0	3.624,6	2.154,4	12,49	10,10	13,52	12,49
Indonesia	13.770,2	16.642,1	18.310,0	17.845,7	2,03	2,30	2,23	2,09
Laos	332,6	1.079,2	967,7	851,4	3,91	7,47	4,00	6,04
Malaysia	9.155,9	10.180,0	3.511,8	9.389,8	4,27	3,27	2,51	3,43
Myanmar	2.248,8	2.824,5	2.205,6	2.235,4	0,01	6,48	2,53	3,33
Filipina	1.298,0	5.639,2	6.585,6	5.906,0	0,51	1,84	2,30	1,86
Singapura	57.460,6	59.702,3	90.597,7	71.156,9	23,07	22,65	32,17	22,98
Thailand	14.746,7	8.927,7	-4.848,9	7.714,7	4,32	2,22	0,88	2,16
Vietnam	8.000,0	11.800,0	15.800,0	11.627,9	6,90	6,11	6,15	5,89

Notes: *) source of World Development Indicators, World Bank Data, January 2022, http://data.worldbank.org/data-catalog/world-development-indicators, **) from year 2010-2019.
Source of: ASEAN Secretariat Database, ASEAN Secretariat, Januari 2022, https://data.aseanstats.org.

Questions about the factors influencing FDI capital flows to Indonesia have been raised due to Indonesia's low percentage of FDI capital flows compared to other nations in the area. This will be helpful for policymakers as they create an environment for investment in Indonesia, particularly to finance SEZ expansion. As a result, the goal of this study is to identify the variables that affect FDI capital flows in Indonesia.

According to the econometric analysis's findings, interest rates, trade openness, and inflation are significant predictors of aggregate FDI inflows to Australia from 1985 to 1994, according to study by(Yang, J. Y. Y., Groenewold, N., & Tcha, 2000). GDP, a proxy for market size, has an impact on encouraging FDI inflows in addition to trade openness (Boateng, A., Hua, X., Nisar, S., & Wu, 2015). However, a number of other scholars have expanded such studies with other variables, such as labor wages as a factor influencing FDI inflows (Ramasamy, B., & Yeung, 2010). This study will empirically explore the factors that influence FDI in Indonesia, herein referred to as the determinants of FDI in Indonesia, such as interest rates, trade openness, inflation, market size, and changes in wages. Because wages are a new variable that has not been widely included

as a variable affecting FDI inflows in the results of previous empirical studies, researchers need to further examine the effect of wages on FDI inflows in Indonesia. Indonesia's FDI in Development of Special Economic Zones (SEZs) is the reason why this study has that term.

2. Literature Review

FDI is a type of investment made by businesses to grow internationally. (Singhania, M., & Gupta, 2011) contend that in order to gather the resources required for investment in the country, resource-poor nations must rely on foreign investment. This is what Singapore and Switzerland do; despite having few resources, they are nonetheless able to draw in foreign investment. This is due to the fact that a country's economic development depends on how it utilizes its resources (Mankiw Gregory et al., 1992). As a result, FDI can supply the essential technology, resources, and skills if a country lacks them through the spillover effect. The amount of FDI inflows is the metric used to measure FDI, according to prior studies (Boateng, A., Hua, X., Nisar, S., & Wu, 2015); (Huong et al., 2020); (Ramasamy, B., & Yeung, 2010); (Singhania, M., & Gupta, 2011); (Yang, J. Y. Y., Groenewold, N., & Tcha, 2000). The size of FDI capital flows is used in this analysis. Researchers in this study require empirical evidence that can be utilized as a guide or a standard while responding to research questions. As a result, the following findings from earlier studies are used as examples in this study:

In this study, researchers need empirical support that is used as a reference as a benchmark in answering research questions. Therefore, the following are the results of previous studies that serve as a reference in this study:

The goal of the study by (Yang, J. Y. Y., Groenewold, N., & Tcha, 2000) is to use a vector autoregressive (VAR) model to identify the factors that influence foreign direct investment (FDI) in Australia from 1985 to 1994. According to the study's findings, factors influencing FDI inflows to Australia throughout that time were interest rates, wage changes, trade openness, and inflation. While the factors of trade openness and inflation have a negative impact on FDI, the variables of interest rate and wage have a positive impact. Other factors, like GDP, have no impact on FDI inflows in Australia.

The goal of the study by (Boateng, A., Hua, X., Nisar, S., & Wu, 2015) is to determine how macroeconomic factors affected foreign investment inflows (FDI) into Norway between 1986 and 2008. According to the results of the fully modified ordinary least squares (FMOLS) estimator, FDI is positively impacted by trade openness and GDP, but

negatively by interest rate levels. Furthermore, the study's findings suggest that the inflation variable has little bearing on Norway's FDI inflows.

The goal of the study by (Singhania, M., & Gupta, 2011) is to investigate the factors that influenced FDI in India during 1995 to 1997. Autoregressive integrated moving average (ARIMA) analysis is the model that is used. According to the study's findings, only GDP and inflation positively affect FDI in India, while trade openness and interest rates have no such impact.

The goal of the study by (Ramasamy, B., & Yeung, 2010) is to look at how FDI and worker wages have changed in China from 1988 to 2007. An rise in worker wages will have a negative influence on FDI, according to the generalized method of moments (GMM) estimation method results based on the outcomes of the vector autoregressive (VAR) model test. Additionally, a rise in FDI will have a favorable effect on Chinese labor costs.

The goal of the study by (Huong et al., 2020) is to apply a vector autoregressive (VAR) model to analyze the relationship between macro factors and FDI in Vietnam from 2005 to 2019. According to the study's findings, trade openness and FDI have a significant and favorable association. Meanwhile, FDI in Vietnam is unaffected by the GDP variable.

The study (Anyanwu, 2012) uses data from 1996 to 2008 to identify the variables that affect FDI inflows in African nations, including Central Africa, East Africa, North Africa, South Africa, and West Africa. The generalized method of moments (GMM), which yields the best estimator findings, reveals that the trade openness variable has a positive influence on luring FDI into African countries, whereas the financial development variable (a proxy for interest rates) has a negative affect. a continent in Africa. Other factors like GDP and inflation, on the other hand, have no impact on FDI inflows in Africa.

The study (Awad, 2020) examines macroeconomic variables that potentially affect FDI flows for the years 1970 to 2017 in an effort to help Malaysia achieve its goal of becoming a high-income nation. The Autoregressive Distributed Lag (ARDL) analysis is the model that was used. The empirical findings of this paper show that trade openness, inflation, and labor costs have long-term negative effects on FDI inflows, whereas interest rates and GDP have long-term positive effects on FDI inflows in Malaysia.

Using the generalized method of moments (GMM) estimation, the research of (Swamy, V., & Narayanamurthy, 2018) intends to investigate the determinants influencing FDI flows in BRICS countries, including Brazil, Russia, India, China, and South Africa during the period from 2001 to 2015. The empirical findings of this study suggest that the factors

influencing increased FDI flows include trade openness and market size of investment destination nations (measured as a proxy for GDP). Interest rates and inflation, however, have no impact on FDI flows in the BRICS nations.

3. Methods

Since this goal of this study is to employ current theories to show the phenomena that occur in the study, it makes use of quantitative research. so that the impact of one variable on other variables can be measured in this study. The factor influencing foreign direct investment in Indonesia from the second quarter of 2008 to the second quarter of 2021 is the focus of this study. Time series data from authorized secondary sources is the sort of data that is used. Foreign Direct Investment is the dependent variable in this study (FDI). The independent factors are, however, Interest Rates (IR), Trade Openness (TRADE), Inflation (INF), GDP (GDP), and Labor Wages (WAGE).

Table 2: Data Description.

Variable	Notation	Description	Source
Foreign direct investment	FDI	Realization of foreign investment investment	BKPM
Interest rate	IR	One month commercial bank time deposit interest rate	BI
Inflation	INF	Percentage change in consumer price index (inflation/deflation rate) $\%\Delta IHK = \frac{I_n - I_{n-1}}{I_{n-1}} \times 100$	BPS
Trade openness	TRADE	Export value – import value	BI
Gross domestic product	GDP	Gross domestic product at constant prices	BPS
Wages	WAGE	Real wages of workers per day	BPS

The research model is to investigate the relationship between interest rates (IR), trade openness (TRADE), inflation (INF), GDP (GDP), and labor wages (WAGE) with foreign direct investment (FDI) in Indonesia based on previous research, such as (Boateng, A., Hua, X., Nisar, S., & Wu, 2015) and (Huong et al., 2020):

$$FDI_t = A_0 + A_1 IR_{t-1} + A_2 TRADE_{t-1} + A_3 INF_{t-1} + A_4 GDP_{t-1} + A_5 WAGE_{t-1} + e_t$$

(1)

Equation 1 -- Model 1

$$IR_t = A_0 + A_1 FDI_{t-1} + A_2 TRADE_{t-1} + A_3 INF_{t-1} + A_4 GDP_{t-1} + A_5 WAGE_{t-1} + e_t$$

(2)

Equation 2 -- Model 2

$$TRADE_t = A_0 + A_1 FDI_{t-1} + A_2 IR_{t-1} + A_3 INF_{t-1} + A_4 GDP_{t-1} + A_5 WAGE_{t-1} + e_t$$

(3)

Equation 3 -- Model 3

$$INF_t = A_0 + A_1 FDI_{t-1} + A_2 IR_{t-1} + A_3 TRADE_{t-1} + A_4 GDP_{t-1} + A_5 WAGE_{t-1} + e_t$$

(4)

Equation 4 -- Model 4

$$GDP_t = A_0 + A_1 FDI_{t-1} + A_2 IR_{t-1} + A_3 TRADE_{t-1} + A_4 INF_{t-1} + A_5 WAGE_{t-1} + e_t$$

(5)

Equation 5 -- Model 5

$$WAGE_t = A_0 + A_1 FDI_{t-1} + A_2 IR_{t-1} + A_3 TRADE_{t-1} + A_4 INF_{t-1} + A_5 GDP_{t-1} + e_t$$

(6)

Equation 6 -- Model 6

FDI_t, is Indonesia's foreign direct investment (in US dollars), IR is the interest rate (in percent), and Trade openness is measured in US dollars; INF stands for inflation (% change in CPI); Gross domestic product is measured in billions of rupiah; WAGE, or labor wages (in rupiah). The data are not stationary at the level but there is cointegration, hence the analytical technique utilized is a vector error correction model (VECM), a derivative of the vector autoregressive (VAR) method.

4. Result and Discussion

Table 4 is a descriptive statistic in this study. It is known that the average value of this study is positive, with a minimum value of 15,46,196 on the dependent variable, while the maximum value of 8,355,098. The independent variable for the minimum value lies in the TRADE variable of -2.576.17, while the maximum value lies in the WAGE variable of 86.555.

Table 5 is what the unit root test found. Table 5 displays the stationarity test for all variables using the Augmented Dickey-Fuller (ADF) test. The results indicate that, with the exception of GDP, all variables are non-stationary at the 5% level of significance,

Table 3: Research Descritive Statistics

	FDI	IR	TRADE	INF	GDP	WAGE
Mean	6263179.	6.685849	5832.610	0.406981	2179367.	67511.96
Median	6980741.	6.730000	4166.000	0.340000	2161553.	65279.00
Maximum	8355098.	10.75000	84488.00	2.460000	2818722.	86555.00
Minimum	1546196.	3.490000	-2576.170	-0.350000	1523574.	57032.00
Std. Dev.	1682038.	1.369332	11489.47	0.493576	404491.7	6947.529
Skewness	-1.001543	0.332241	6.198878	1.455716	-0.054726	1.952822
Kurtosis	2.958555	3.761870	43.07255	7.057502	1.710487	5.880325
Source: Processed data, 2022.						

Table 4: Unit Root Test.

Test	Augmented Dickey-Fuller					
Variable	Level		Desc.	First Difference		Desc.
	t-stat	Prob.		t-statistic	Prob.	
FDI	-2.016495	0.2791	Non Stasioner	-13.21248	0.0000	Stasioner
IR	-2.522626	0.1162	Non Stasioner	-5.763024	0.0000	Stasioner
TRADE	-4.988318	0.0000	Stasioner	-11.54000	0.0000	Stasioner
INF	0.506301	0.9851	Non Stasioner	-6.465243	0.0000	Stasioner
GDP	-0.453182	0.8907	Non Stasioner	-5.293991	0.0001	Stasioner
WAGE	-0.975859	0.7553	Non Stasioner	-7.333906	0.0000	Stasioner
Source: Processed data, 2022.						

although in first differences all variables are stationary. As a result, the VECM estimation in first differences must be used to analyze the relationship between interest rates, trade openness, inflation, GDP, and wages. This makes the equation:

$$DFDI_t = A_0 + A_1 DIR_{t-1} + A_2 DTRADE_{t-1} + A_3 INF_{t-1} + A_4 DGDP_{t-1} + A_5 DWAGE_{t-1} + e_t$$

The number of cointegration vectors, trace statistics, and the maximum Eigenvalue test were all determined using the cointegration test. There are five cointegrations for long-term impacts where the trace statistic value is more than the 5% critical value, according to Table 6 on none, at most 1, at most 2, at most 3, and at most 5. But it differs from at most 4, which demonstrates that the crucial value is greater than the trace value and that at most 4 there is no cointegration.

Furthermore, Table 7 in the none section shows the existence of cointegration where the max-eigen statistic value is > 5% critical value. Based on Table 6 and Table 7 there is a cointegration, then the VECM test in this model can be carried out.

The results of the calculation show that the t-table obtained in the study is 2.00000, it can be concluded that the results of the VECM test in the long term have 4 influential

Table 5: Cointegration Test (*Trace*).

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.758560	152.7915	95.75366	0.0000
At most 1 *	0.470643	81.73470	69.81889	0.0042
At most 2 *	0.314160	49.93012	47.85613	0.0315
At most 3 *	0.268194	31.07459	29.79707	0.0355
At most 4	0.168757	15.46260	15.49471	0.0506
At most 5 *	0.116990	6.220916	3.841466	0.0126
Source: Processed data, 2022.				

Table 6: Cointegration Test (*Maximum Eigenvalue*).

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.758560	71.05680	40.07757	0.0000
At most 1	0.470643	31.80458	33.87687	0.0866
At most 2	0.314160	18.85553	27.58434	0.4258
At most 3	0.268194	15.61199	21.13162	0.2483
At most 4	0.168757	9.241685	14.26460	0.2666
At most 5 *	0.116990	6.220916	3.841466	0.0126
Source: Processed data, 2022				

variables, namely the interest rate variable, trade openness, inflation, and GDP which can be proven by the t-statistic value of each variable > 2.00000.

Table 7: Long-Term Estimation Results.

Variable	Coefficient	t-stat	t-tabel	Desc.
LOG (FDI (-1))	1.000000		2.00000	Non Significant
IR (-1)	-1.183311	[-2.30317]		Significant
TRADE (-1)	0.000631	[6.70508]		Significant
INF (-1)	24.46494	[9.36293]		Significant
GDP (-1)	18.96903	[4.79459]		Significant
WAGE (-1)	-8.22E-05	[-0.86325]		Non Significant
C	-291.4188			
R^2	0.880979			
Source: Processed data, 2022				

The IR variable has a t-statistical value > t-table, indicating that it has a long-term, sizable negative impact on inflows of foreign direct investment. The findings of this analysis are consistent with (Boateng, A., Hua, X., Nisar, S., & Wu, 2015) who predicted that an increase in FDI inflows would arise from low interest rates giving investors a cost

advantage. Therefore, it has been established that there would be a negative correlation between Indonesia's interest rates and FDI inflows.

The TRADE variable has a t-statistical value > t-table, indicating that it has a large long-term positive impact on inflows of foreign direct investment. The findings of this research are consistent with (Boateng, A., Hua, X., Nisar, S., & Wu, 2015). Thus, increased FDI inflows to Indonesia during the past ten years have been influenced by export-driven trade openness. Therefore, this research hypothesis demonstrates that there would be a positive correlation between trade openness and FDI inflows in Indonesia.

The INF variable has a t-statistical value > t-table, indicating that it has a sizable long-term positive impact on inflows of foreign direct investment. The findings of this research are consistent with (Singhania, M., & Gupta, 2011). It is anticipated that Indonesia would have an increase in FDI inflows with an inflation rate of 3.01%. As a result, the study's hypothesis that there will be a positive correlation between Indonesian inflation and FDI inflows is supported.

The GDP variable, which serves as a surrogate for market size, has a t-statistic value of > t-table, indicating that it has a strong long-term positive impact on inflows of foreign direct investment. The findings of this research are consistent with (Boateng, A., Hua, X., Nisar, S., & Wu, 2015). For international investors, the market potential in Indonesia are greater and more alluring. Thus, the study's hypothesis that there would be a positive correlation between Indonesia's GDP and FDI inflows is supported.

Since the WAGE variable has a t-statistic value of 0, it has no impact on long-term inflows of foreign direct investment. A driving factor for FDI inflows to China, according to (Ramasamy, B., & Yeung, 2010), is lower wage costs, however there is a negative correlation between the two. In Indonesia, wages are one of the political decisions made by each regional head since they set the pay for their respective regions. Because of the disparity in the established wage norms, the impact of wages on FDI in Indonesia is not yet obvious. Therefore, the claim made in this study that there will be a negative correlation between WAGE and FDI inflows to Indonesia is not supported.

The outcomes of the VECM estimation also demonstrate how the short term influences the variables affecting FDI in Indonesia. According to Table 9, the estimation findings reveal that only the IR and TRADE factors significantly reduce the amount of foreign direct investment that Indonesia receives.

To evaluate the model further, it is necessary to describe the performance of the model built on the research. Figure 1 explains that FDI inflows in Indonesia fluctuated greatly during the 2008 2nd quarter to 2nd quarter 2021, although the forecasting

TABLE 8: Short-Term Estimation Results.

Variable	Coefficient	t-stat	t-tabel	Desc
D (LOG (FDI (-1)))	-0.449254	[-2.85614]	2.00000	Significant
D (LOG (FDI (-2)))	0.195412	[2.10108]		Significant
D (IR (-1))	0.067128	[2.04457]		Significant
D (IR (-2))	-0.082415	[-2.57188]		Significant
D (TRADE (-1))	-8.73E-06	[-5.65287]		Significant
D (TRADE (-2))	-5.01E-06	[-2.34604]		Significant
D (INF (-1))	-0.103989	[-1.89641]		Non significant
D (INF (-2))	-0.059681	[-1.80625]		Non significant
D (LOG (GDP (-1)))	-0.578076	[-0.90077]		Non significant
D (LOG (GDP (-2)))	-0.497829	[-0.77360]		Non significant
D (WAGE (-1))	6.88E-06	[1.46935]		Non significant
D (WAGE (-2))	-3.71E-06	[-0.74359]		Non significant
C	0.031235	[1.67045]		Non significant
R^2	0.880979			

Source: Processed data, 2022

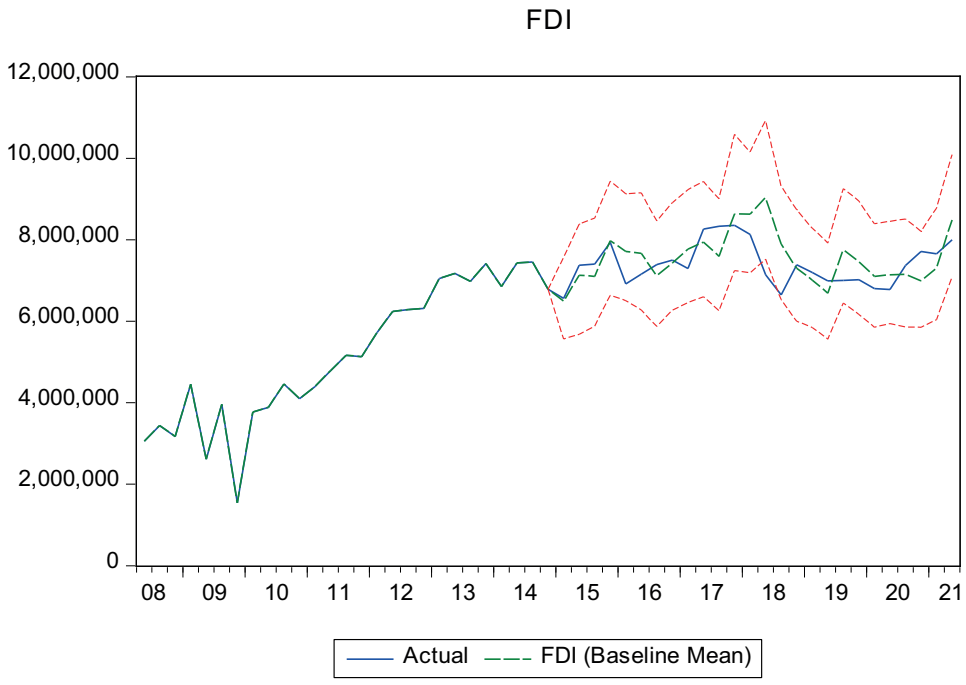

Figure 1: Indonesia FDI Forecasting Results.

ability to track the dependent variable was better at the beginning of the period, while in the 2018 period the actual value was lower than the forecasting value.

From Table 10, it is clear that in the second period, the shock of foreign direct investment inflows itself had a 100% impact on employment. The factors IR, TRADE, INF, LOG(GDP), and WAGE, however, had little impact on FDI inflows during the second

Table 9: Variance Decomposition from LOG(FDI).

Variable	Period = J	1	2	3	4	5
LOG(FDI)	VR(J)	100.0000	62.82691	78.49981	75.98377	76.85740
IR	VR(J)	0.000000	16.40788	6.220053	6.544936	5.814755
TRADE	VR(J)	0.000000	13.48140	8.480501	7.720206	8.252505
INF	VR(J)	0.000000	3.668325	4.862911	5.980869	5.934228
LOG(GDP)	VR(J)	0.000000	0.562964	0.508870	1.102993	1.002727
WAGE	VR(J)	0.000000	3.052522	1.427851	2.667231	2.138388

Source: Processed data, 2022

period. The shock of foreign direct investment inflows had varying degrees of consequences on those inflows themselves from the first to the tenth period. In period 2, the IR variable contributed by 16,40788 percent.

5. Conclusion

Indonesia is among a group of nations in the ASEAN that receive significant FDI capital flows. Over the past ten years, Indonesia has continuously ranked second to Singapore as the country receiving the most FDI. However, when compared to other nations in the region, Indonesia comes in last when looking at the ratio of FDI flows to gross domestic product (GDP). Questions about the factors influencing FDI capital flows to Indonesia have been raised due to Indonesia's low percentage of FDI capital flows compared to other nations in the area. The research's findings will help policymakers create an environment that encourages investment in Indonesia, particularly to finance SEZ growth. As a result, the goal of this study is to identify the variables that affect FDI capital flows in Indonesia.

Even the interest rate and trade openness factors have an impact on FDI inflows in Indonesia during the near run. This is consistent with the findings of earlier empirical studies that found these two variables to be crucial for FDI inflows. Only the wage variable, however, has little impact on Indonesia's FDI inflows over the long run. This is possible as a result of the political nature of wages, which in Indonesia are decided by the decisions of each regional head. Because wages are a novel variable that has not been widely included as a variable that impacts FDI inflows in the findings of prior empirical research, it is vital to further explore the impact of wages on FDI inflows in Indonesia.

Based on these conclusions, researchers can provide suggestions as follows:

1. Given that salaries are a recent component that have not been extensively included as a variable determining FDI inflows in the findings of prior empirical studies, researchers must further investigate the impact of wages on FDI inflows in Indonesia.
2. In order to increase FDI inputs, the government must be more vigilant in monitoring economic circumstances, particularly Interest Rates, Inflation, Trade Openness, and Gross Domestic Product, which are factors for FDI inflows in each country. It is anticipated that this will draw in foreign investors. By establishing a fair distribution of development and social welfare in Special Economic Zones, it can raise each nation's economic level (SEZs).
3. Investors should exercise greater caution when deciding which nation to invest in and understand the opportunities and hazards associated with doing so in developing nations. Investors are expected to do this in order to increase profits and decrease losses.

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