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The Role of Political Stability and Foreign Direct Investment in Indonesia's Economic Growth

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A B S T R A C T

This study aims to determine how the role of political stability and foreign direct investment to economic growth in indonesia. This study also aims to examine the influence of political stability and foreign direct investment (FDI) in playing an important role in economic growth in 34 provinces in Indonesia for the period 2018-2022. The method used in this study is a quantitative research method using secondary data in the form of panel data. The analysis tool used is panel regression. It was found that the positive relationship between political stability, Foreign Direct Investment (FDI), has a very important role for economic growth in Indonesia.

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INTRODUCTION

Economic growth is a development of an economic activity that encourages an increase in output in the community and encourage increased prosperity and welfare of the community. Output circulating in the community include goods and services (Sukirno, 2000).

Political stability and FDI, or foreign direct investment, is crucial to Indonesia's economic expansion. Political stability can improve economic growth by facilitating foreign investment and fostering investor trust. It takes foreign investment to create economic acceleration. This is so that more possibilities may be created by industrialization, which can be aided by foreign finance. Foreign capital supplied in the form of technological support as well as financial assistance (Jhingan, 2004).

In recent years, Indonesia has experienced significant economic growth, but political stability and FDI are still important factors in determining the country's economic progress.

However, keep in mind that political stability and FDI do not work alone. Other factors such as government spending, and employment also affect economic growth. Therefore, a deeper analysis is needed to understand the interaction between political stability, FDI, and other economic factors in boosting Indonesia's economic growth.

Previous studies have shown that political stability and FDI have an effect on economic growth. For example, research conducted by Salsabila (2013) said that the influence of FDI on economic growth in Indonesia cannot necessarily have a positive impact, because based on various literature that FDI interacts in a complex manner with various factors in a region before it can contribute to economic growth. Incoming FDI must in fact interact with the labor market so that workers gain skills and knowledge from the transfer of technology due to FDI that is sustainable even when FDI is no longer in the region, research conducted by Bari (2013) in research on foreign investment on economic growth in Bangladesh and India. That foreign investment has a significant positive relationship with the economic growth of Bangladesh. On the other hand in India, foreign investment has a positive correlation is not significant to economic growth, research conducted Wahiba (2014) that foreign investment contributes to Tunisia's economic expansion. The research was carried out between 1980 and 2011. In addition to the naming of foreign capital that affects economic growth in Tunisia, there are other factors, namely open markets, commercialization of technology and communications, and M2 money supply, research from Abate (2022) shows that aid has a negative influence on economic growth when the institutional quality index is low, the study recommends developing countries not to receive large amounts of aid from donors. Instead, they were told that in order to benefit from the aid, they needed to improve their institutions and grant more economic freedom.

Given the context of these issues, scholars are eager to investigate how political stability and foreign direct investment contribute to Indonesia's economic expansion. This study is more focused on national-level time series data on economic growth, FDI, IDI, labor and government spending.

LITERATURE REVIEW

Economic Growth

A country or region experiences economic growth when its production of products and services rises over time. The assessment of economic growth is conducted using metrics including per capita income, GDP, and gross national product (GNP).These indicators are used to measure the size and economic performance of a country in achieving significant economic improvement (Todaro & Smith, 2013). Resources such as labor, capital, and raw materials used in the production process are called factors of production. Productivity can increase as a result of the increase in production factors that ultimately affect economic growth. According to Solow (1956) the increase in production factors, as measured by the growth rate of output per hour worked, is the cause of economic growth.

Economic growth theory acknowledges that a nation's economic growth can be impacted by technical advancements. Technological innovation can lead to higher production efficiency and productivity as well as new avenues for value creation and job creation. Economic growth theory acknowledges that a nation's economic growth can be impacted by technical advancements. Technological innovation can lead to higher production efficiency and productivity as well as new avenues for value creation and job creation. These innovations can contribute to economic growth for a long period of time. On the other hand, Solow (1956) introduced the concept of "Solow residue" which refers to economic growth that cannot be explained solely by increasing factors of production, but also by increasing technological innovation. This concept explains that the factor of technological innovation has an important role in promoting economic growth that cannot be explained traditionally through the increase in production factors alone.

Foreign Direct Investment

Multinational corporations make international equity investments known as foreign direct investment, or FDI. As a result, when national development is measured in terms of GDP growth rate, the most often mentioned contribution of foreign direct investment is its function in bridging the resource gap between intended or desired investments (Todaro & Smith, 2013).

Political Stability

Political stability is the state of having a stable political system, free from popular unrest or political violence, which permits the government and state institutions to function effectively. Political stability is critical to economic development, as it can provide an environment conducive to investment, trade, and sustainable economic growth. Unstable political conditions can negatively affect a country's economy, for example by disrupting production, trade, investment and consumption. Therefore, political stability is a key factor in

making investment and business decisions, as well as the economic policy of a country (Schumacher, 2013).

This concept defines stability and instability as the potential associated with such conformity, rather than just actual events. This study also proposed five operational concepts to measure and compare political stability in different political objects (Margolis, 2010). Such concepts include:

a. Legitimacy: the degree of acceptance of the role and formal and informal structure of political objects by constituents and external actors.
b. Resilience: the ability of a political object to overcome or recover from shocks or challenges both internal and external.
c. Adaptability: the ability of political objects to adapt or change formal and informal roles and structures in the face of changing situations or demands.
d. Cohesion: the degree of consistency and conformity between the roles and formal and informal structures of political objects.
e. Capacity: the ability of a political object to carry out its functions and achieve the objectives set.

Indicators such as public opinion surveys, institutional indices, Conflict data, economic statistics, and social indicators can be used to operationalize these concepts. However, keep in mind that there is no single or definitive approach to measuring political stability and instability, and variations in methods can produce different results (Perlikowski, 2021).

Political stability in developing countries has an influence on economic growth supported by foreign investment and foreign aid. This can be seen from the fact that political instability can hinder efforts to provide foreign aid, thereby reducing interest in investment from abroad. Thus, political stability is a critical factor to take into account while attempting to promote economic growth in developing nations through foreign aid and foreign investment, given the influence of these factors on economic growth (Asiedu, 2006).

The Relationship of Foreign Direct Investment to Economic Growth

Solow (1956) introduced the concept of "Solow residue" which refers to economic growth that cannot be explained solely by increased factors of production, but also by increased technological innovation. According to this theory, technological innovation has a significant role in fostering economic growth and is not well explained by traditional theories that rely solely on an increase in production variables. According to Panayotou (1998) foreign direct investment has great potential to boost economic growth through technology transfer, new market access, job creation, and stimulation of domestic investment. However, it is also important to create a conducive environment for foreign direct investment, including clear investment policies, legal protection, and adequate political stability.

Research from Dabour (2000) discovered that FDI can assist OIC economies in achieving their financial objectives. For OIC nations, foreign direct investment (FDI) offers numerous benefits, including bolstering their domestic savings and investments and providing access to international markets, business culture, technology, and management expertise.Likewise, the research

of Samimi, Rezanejad, and Ariani (2010) based on empirical results that FDI and openness have a positive impact on growth in OIC countries. Additionally study finds FDI causes GDP growth in OIC countries.

Relationship of Political Stability in Moderating Foreign Aid and Foreign Direct Investment to Economic Growth

There are two ways to observe political instability: signs of civil unrest and political violence, as well as executive instability. Executive instability refers to a change in government, either "constitutional" or "unconstitutional", such as a coup. A high rate of executive change can lead to policy uncertainty and threaten property rights. It is important to note that the trend of executive change may differ from the actual frequency of change (Alesina & Perotti, 1996).

Economic growth on foreign investment in improving economic development can also be influenced from political stability in developing countries. Foreign aid efforts can be hampered by political instability, which can make it less attractive for investment from abroad. Therefore, considering the impact of FDI and foreign aid on economic growth in developing countries, political stability can be an important consideration (Asiedu, 2006).

Armah's (2010) research found that growth depends on political stability because they believe aid can spur growth, the Millennium Development Goals (MDGs) for SSA nations depend on a stable political climate. Drawing on the previously mentioned discourse, the research hypothesis is articulated as follows:

METHODOLOGY

Quantitative approaches were employed in this investigation. Research that displays data as numbers as a consequence of the investigation is known as quantitative research. Panel data, a type of data, is used in this study as secondary data. This study The BPS and several other official internet sources provide data for this study. A population is a comprehensive collection of items that typically consists of the people, things, transactions, or events that are the subject of our study (Kuncoro, 2013). 34 Indonesian provinces are the people that this study is focusing on. Because the sample is drawn from a subset of the population for research purposes, it serves as a representative of the full population. (Sekaran & Bougie, 2016). This study uses data on economic growth, FDI, Indonesia Democracy Index as a proxy for political stability and The Open unemployment rate during the period 2018-2022.

The operational definition of the variables used in this study is:

a) Economic growth (Y): this study uses GDP ADHK obtained from BPS RI and transformed in the form of logs.
b) Political Stability (X1): the indicator of political stability to be used is the Indonesian democracy index. The Indonesian democracy index reflects perceptions about the country's ability to regulate and maintain political stability in the country. The Data can be found on the Indonesian Central Statistics Agency website and is calculated using annual data.

c) Foreign Direct Investment (FDI) (X2): the amount of direct investment from foreign investors in the form of capital, technology, and skills in a country, the value of FDI is calculated in units of US Dollars (US$).
d) Open unemployment rate (X3): the open unemployment rate for the period 2018-2022 downloaded from BPS is measured in Percent units.

Analysis Techniques

The eviews 9 program is then used to examine the data that has been gathered. In this study, panel data from 34 Indonesian provinces are used. Additionally, the time series data spans 2018 through 2022. This study will explain the relationship between the independent variables of political stability (X2) and foreign direct investment (X1) and the dependent variable of economic growth (Y). The investigation was conducted in phases. Initially, the Chow test was used by the researchers to choose amongst Pooled Least Square (PLS), Common Effect, and Fixed Effect models. The Hausman test was then used to determine whether to use Fixed Effect or Random Effect. The findings of moderation were revealed at the final step by the application of Moderated Regression Analysis (MRA) and hypothesis testing.
Model the equation PE = α + β1.I*D*I + β2.FD*I* + β3.TPT+ *e*

Where:
GDP = economic growth
A = constant
b1- b5 = regression coefficient
Idi = Democracy Index
FDI = foreign direct investment
TPT = labor force
E = Error Term, or the level of error in the research estimator

RESEARCH RESULTS

Model selection analysis

This study uses panel data and three regression models: the random effect model, the fixed effect model, and the common effect model. selecting the best panel data regression model to evaluate the hypothesis of the study, a test selection process was carried out. Eviews 9 software is used to assist in the selection of models. To choose the ideal model for this investigation, a model selection test will also be carried out.

1. Uji Chow

The Chow test is a tool used in panel data estimation that helps identify the best fixed effect or common effect model.
H0 = Common Effect Model (CEM)
Ha = Fixed Effect Model (FEM)

Estimated Results of the Chow Test

Effects test	Statistic	d.f.	Prob.
Cross-section F	2.601300	(33,133)	0.0001
Cross-section Chi-square	84.660840	33	0.0000

Source: Processed Data Eviews 9

The likelihood of the Cross-section F statistic is 0.0001, which is less than the significance level of a = 0.05, based on the data given. The fixed effect model is the most appropriate model to apply in order to reject H0 and accept Ha. To ascertain which of the fixed effect and random effect models is superior, the Hausman test must be performed.

2. Uji Hausman

With the following hypothesis, the Hausman test is utilized to determine which of the two models—the random effect model or the fixed effect model—is optimal:

H_0 = *Random effect Model* (REM)

H_a = *Fixed effect Model* (FEM)

The Hausman Test

Test Summary	Chi-Sq Statistic	Chi-Sq d.f.	Prob.
Cross-section random	26.060238	3	0.0000

Source: Processed Data Eviews 9

With a chance of 0.0000 or less than the chosen threshold of significance, ③ = 5% or 0.05, the Hausman Test results in the preceding data demonstrate that Ha is accepted and H0 is rejected, indicating that the Fixed Effect Model (FEM) is a more appropriate choice than the Random Effect Model (REM). The Fixed Effect Model (FEM) is the most suitable and relevant model utilized in this investigation, according to the estimation results of the panel data model mentioned above.

Hypothesis Test Analysis

Hypothesis tests in this study include, significant test together called the partial test, the significance test of individual parameters or called the simultaneous test, and the coefficient of determination (R2).

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	12.80650	5.720682	2.238631	0.0268
X1	0.061271	0.074032	0.827619	0.4094
X2	0.000925	0.000460	2.011781	0.0463

X3	-2.788247	0.367940	-7.578000	0.0000
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.520182	Mean dependent var		3.817235
Adjusted R-squared	0.390307	S.D. dependent var		4.258891
S.E. of regression	3.325463	Akaike info criterion		5.430940
Sum squared resid	1470.808	Schwarz criterion		6.113437
Log likehood	-424.6299	Hannan-quinn criter		5.707889
F-statistic	4.005242	Durbin-watson stat		2.130669
Prob(F-statistic)	0.000000			

Source: Processed Data Eviews 9

Simultaneous Test

Seeks to demonstrate whether the influence of each independent variable on the dependent variable is cumulative. Whether all independent variables have an impact on the dependent variable in line with the null hypothesis statement (H0) is the hypothesis that is being tested. In light of the outcome, H0 will be rejected when H0 < 0,05 and accepted when H0 > 0,05. Based on the estimated values, which yielded a probability (Fstatistic) value of 0.000000 < 0.05, it may be inferred that H0 is rejected, indicating that the independent factors collectively have an impact on the dependent variable.

Partial Test

A partial test was performed to ascertain whether the independent variable had any influence on the dependent variable. Based on the results of this partial test and the hypothesis test of the partial regression coefficient, it can be concluded that the independent variable significantly affects the dependent variable if the probability value of t is less than 0.05.

The partial association between the independent variables—IDI, foreign investment, and TPT—and the dependent variable—economic growth—can be understood in light of the aforementioned findings. Given that the probability value of the IDI is 0.4094, or greater than 0.05, it can be said that the IDI has no appreciable impact on economic growth. Given that the likelihood of foreign investment is 0.0463, or less than 0.05, it can be said that foreign investment value significantly influences economic growth. Furthermore, TPT has a probability of 0.0000, or less than 0.05, indicating that it has a considerable impact on economic growth.

Determinant Coefficient

The dependent variable's degree of explanation by the model, as observed from the adj value, is gauged by the coefficient of determination. R-square is a coefficient that, in the event that variables or samples are increased, has been adjusted for sample size and number of variables to lessen bias. Based on the data presented above, the adjusted coefficient of determination (adj. R-square) is 0.390307, indicating that the three independent variables account for

39.03% of the growth in the economy. While other factors not included by the study can account for the remaining 60.97%.

Based on the results of the calculation of panel data using the Fixed Effect regression Model, the regression equation is obtained as follows:

Y = 12.80650+ 0.061271X1 + 0.000925X2 - 2.788247X3 + e

1. It can be concluded as follows:
   Constant value of 12.806496 means that if the variable X1, X2, X3 is equal to 0 then the economic growth of 1280%
2. Variable IDI (X1) has a coefficient of 0.0612. This illustrates that every X1 increase of 1 percent will increase economic growth by 6 percent and vice versa.
3. Foreign investment variable (X2) has a coefficient value of 0.0009. This illustrates that every X1 increase by 1 percent will increase economic growth by 1 percent and vice versa.
4. Variable TPT (X3) has a coefficient value of -2,788. This illustrates that every X1 increase of 1 percent will reduce economic growth by 278 percent and vice versa.

Classical Assumption Test Analysis

Classical assumption test is done so that the results of regression analysis obtained are more accurate. In this study the assumption test used is multicollinearity test and heterokedasticity test.

1. Multicollinearity Test

Multicollinearity Test

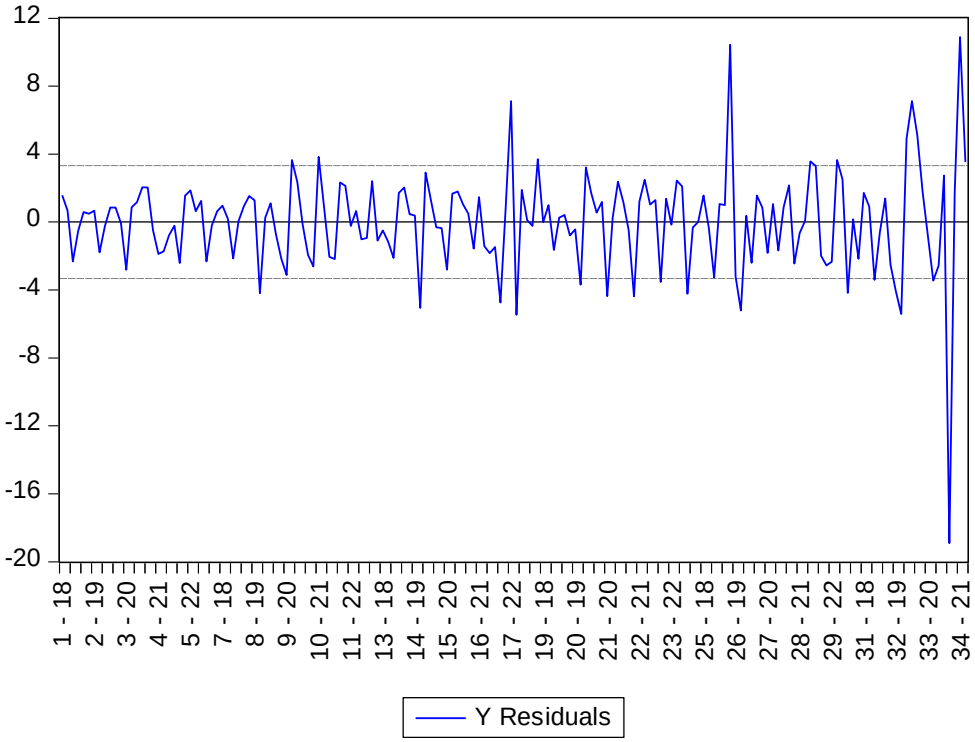
	X1	X2	X3
X1	1.000000	0.093306	0.110997
X2	0.093306	1.000000	0.382066
X3	0.110997	0.382066	1.000000

Source: Processed Data Eviews 9

The number reached if the correlation between X1 and X2 is 0.093306, X1 and X3 are 0.110997, and X2 and X3 are 0.382066, is based on the data above. This suggests that there is less than a 0.85 correlation value. We may conclude that there are no multicollinearity issues with the data.

2. Heteroscedasticity Test

Heteroscedasticity Test



Source: Processed Data Eviews 9

From the residual graph it can be seen that it does not cross the line (500 and -500), which means that the residual variance is the same. Therefore, there are no symptoms of heteroskedasitas.

DISCUSSION

Based on findings from studies on the impact of foreign direct investment and political stability on economic growth in Indonesia, model selection was examined using panel data and three regression models: a common effect model, a fixed effect model, and a random effect model. In the selection of models conducted a test in which to find out which model is the best in this study. In the chow Test, there are data obtained cross-section probability F statistics of 0.0001 which means less than the significance level of a = 0.05. So that H0 is rejected and Ha is accepted, then the best model to use is the fixed effect model. So it is necessary to do hausman test to determine which model is the best between fixed effect model and random effect model. The Hausman test indicates that the Fixed Effect Model (FEM) is preferable to the Random Effect Model (REM) when the probability of the data acquired is 0.0000 or less than the significance level employed, which is ③ = 5% or 0.05. The Fixed Effect Model (FEM) is the most suitable and relevant model utilized in this investigation, according to the estimation results of the panel data model mentioned above.

In the analysis of the hypothesis test results this study includes a significant test together called the partial test, the significance test of individual

parameters or called the simultaneous test, and the coefficient of determination (R2). Data from the simultaneous test show that every independent variable influences the dependent variable in a way that supports the null hypothesis (H0). In light of the outcome, H0 will be rejected when H0 < 0,05 and accepted when H0 > 0,05. Based on the estimated values, which yielded a probability (Fstatistic) value of 0.000000 < 0.05, it may be inferred that H0 is rejected, demonstrating that the dependent variable is impacted by the independent components taken together. Data gathered from the partial test's effect of the independent variable on the dependent variable is used to test the hypothesis of the partial regression coefficient. If the probability test's value of t is less than 0.05, it can be said that the independent variable significantly affects the dependent variable.

Based on the above results can be explained how the partial relationship between the independent variables, namely the probability value of iindeks demokrasi Indonesia (IDI) of 0.4094 which means more than 0.05 so it can be concluded that the Indonesian democracy index (Idi) has no significant effect on economic growth the results of this study are in line with research conducted by Yusuf et al. (2020) that democracy both in the short term and in the long term has no influence on economic growth in the region of West African countries and also research from (Shalihah, H. F., & Febriani, R. E. 2023) shows that democracy has no significant effect on government spending. This is due to several factors, including stable economic priorities and government policies that do not interfere with economic growth in indonesia. Foreign investment has a probability of 0.0463 which means less than 0.05 so that it can be concluded that the value of foreign investment has a significant effect on economic growth the findings are also in line with the results of research that revealed that in the long term foreign investment has a negative impact and is not significant to economic growth (Shabbir et al., 2021; Uwubanmwen & Ogiemudia, 2016) so that the government needs to think about and monitor incoming direct investment funds, especially from China, because when economic uncertainty in China increases, it will lead to reduced foreign direct investment from China entering Indonesia. The importance of improving quality human resources so that it can bring progress to the country, especially public welfare, which will attract investors to invest so that there will be a surplus of Foreign Investment (FDI) entering Indonesia (Ulfa, M. A., & Febriani, R. E. 2023). And TPT has a probability of 0.0000 which means less than 0.05 so it can be concluded that the value of TPT has a significant effect on economic growth the results of this study are in line with (Masruroh, 2020), TPT has a negative and significant effect on economic growth in East Java and also the results of research from (Florennica, E., & Febriani, R. E. 2023). Considering the significance that the unemployment rate plays, it is implied that there is a tenuous connection between poverty and unemployment. The impact of poverty is typically influenced by the rate of unemployment. Furthermore, improved human resource quality, a wide range of work options, and a low unemployment rate can all contribute to the reduction of poverty, which in turn has an impact on Indonesia's economic growth. In the determinant coefficient, there are data obtained showing the value of the

adjusted coefficient of determination (adj. R-square) of 0.390307 this shows that 39.03% of economic growth can be explained by the three independent variables. While the remaining 60.97% can be explained by other variables that are not studied. In the above results are also the result of the calculation of panel data using a regression model Fixed Effect Model so as to obtain :

1. Constant value of 12.806496 means that if the variable X1, X2, X3 is equal to 0 then the economic growth of 1280%
2. Variable IDI (X1) has a coefficient of 0.0612. This illustrates that every X1 increase of 1 percent will increase economic growth by 6 percent and vice versa.
3. Foreign investment variable (X2) has a coefficient value of 0.0009. This illustrates that every X1 increase by 1 percent will increase economic growth by 1 percent and vice versa. Variable TPT (X3) has a coefficient value of -2,788. This illustrates that every X1 increase of 1 percent will reduce economic growth by 278 percent and vice versa.

And in the analysis of classical assumption test regression analysis results can be obtained more accurately by using multicollinearity test and heteroscedasticity test, based on multicolinearity test obtained correlation values between X1 and X2 of 0.093306, X1 and X3 of 0.110997 and X2 and X3 of 0.382066. This indicates that the correlation value is less than 0.85. It can be concluded that the data does not occur multicollinearity problems. While based on the heteroscedasticity test can be seen from the chart table 4.4 does not cross the limit (500 and -500) means that the residual variant is the same. Therefore, there are no symptoms of heteroscedasticity.

CONCLUSION

Based on the results of research that has been done, the conclusion obtained is that strong political stability creates certainty and confidence for investors, encouraging an increase in foreign direct investment (FDI) to Indonesia. Foreign Direct Investment (FDI) brings the capital, technology, and management needed to drive long-term economic growth. However, political stability is also important to maintain a conducive investment environment and ensure the long-term viability of investments. Therefore, the positive relationship between political stability, Foreign Direct Investment (FDI), and economic growth is very important for Indonesia. Political stability and Foreign Direct Investment (FDI) have a very significant role in influencing Indonesia's economic growth. Solid political stability provides the necessary foundation for sustainable investment and stable economic growth. When countries have high political stability, investors tend to feel more confident about investing their capital over a long period of time.

Foreign Direct Investment (FDI) also plays an important role in accelerating economic growth. Through Foreign Direct Investment (FDI), Indonesia can access capital, technology, and managerial skills from foreign investors. This helps to increase the productivity and competitiveness of the Indonesian economy on a global scale. In addition, Foreign Direct Investment (FDI) can also help expand Indonesia's export market by building strong trade

relations between foreign and domestic countries. However, it is important to remember that political stability and Foreign Direct Investment (FDI) are not the only factors affecting Indonesia's economic growth. Other factors such as economic policy, infrastructure, education, and global uncertainty also play an important role. Therefore, to achieve sustainable economic growth, Indonesia needs to adopt policies that support strong political stability, as well as pro-investment policies that are attractive to foreign investors.

In addition, the government should also commit to improving the domestic investment climate by simplifying regulation, increasing legal security, and promoting innovation and entrepreneurship. Thus, Indonesia can increase its attractiveness as an investment destination, which in turn will promote stronger and more inclusive economic growth for all communities.

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