Analyzing the Effects of Openness and Political Variables on FDI in Indonesia

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Abstract

To recognize the importance of investment flows as one of the components of development, ASEAN member countries have created the ASEAN Economic Community (AEC) 2015 blueprint as guidelines for setting up a free and open investment regime in ASEAN. The enactment of AEC makes the issue of foreign direct investment (FDI) in Indonesia more attractive. However, an increase in FDI is followed by uneven absorption of FDI in various regions of Indonesia. The implementation of regional autonomy, which gives more authority to governors, allegedly influence investors' decision to invest. This study aims to determine whether the disclosure of openness and the presidential election have an influence on FDI inflows across 30 provinces of Indonesia. This study employs panel data regression with a fixed effect model. The findings suggest that the level of openness and political variables contribute to the absorption rate of FDI inflows in the regions.

Keywords: Foreign Direct Investment, Openness, Political Variables
JEL Classification: C5, O1, R5

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I. Introduction

1.1. Background

The ASEAN Economic Community (AEC) 2015 Blueprint, which has been planned in the past few decades, has raised awareness of Foreign Direct Investment (FDI) in ASEAN countries and all over the world. Globalization becomes an essential factor affecting high awareness of the importance of FDI in a country. Hsia and Shen (2003) mention that FDI has a positive effect on the economic growth of a country. This means that the higher FDI flows into a country are, the higher the growth rate of the country is. This statement is also strengthened by the Harrod-Domar growth model, which states that an economy requires new investment to spur economic growth as it creates additional net capital to reserves or capital stocks.

Todaro (2012) also mentions that measurement of development success in developing countries can be performed by increasing the economic growth. The AEC 2015 blueprint sets a number of goals to be achieved and one of them is higher economic growth. Therefore, ASEAN countries are becoming more concerned about attracting investors to their countries, especially developing countries that still encounter the problem of low and unstable economic growth.

FDI has many other positive effects in addition to the impact on economic growth. According to Ho and Rashid in Jadhav (2012), foreign investment can raise investment and increase capital stocks. Foreign investment can also increase employment by creating jobs and technology transfer. Walsh and Yu (2010) state that FDI can provide access to international markets and allow transfer of technology and specific expertise. Jaumotte (2004) also mentions in his research that in addition to creating jobs, FDI can provide incentives to domestic manufacturers to improve efficiency and enable technology transfer to FDI recipient countries. Thus, local communities will get the chance to develop through technological advances and adjust their product to meet the international standards to compete with products from other countries.

Indonesia has been focusing on boosting FDI inflows as they benefit and have a positive impact on the economy. The presence of the AEC 2015 blueprint makes Indonesia increasingly concerned about FDI. According to the ASEAN Investment Report 2015, Indonesia is the second largest country after Singapore,

and contributes 16% of the total FDI inflows in ASEAN. The increase in FDI inflows into Indonesia cannot be separated from the amandementof Law No. 1 of 1967 on foreign investment into Law No. 25 of 2007 on investment, which makes it easier for foreign investors to invest in Indonesia, in addition to AEC 2015.

In contrast to the other ASEAN countries, Indonesia is an archipelagic country with abundant resources and each region of Indonesia has its own uniqueness. If the potential of each region can be optimized, it is expected that more foreign investors will invest in Indonesia. With the implementation of AEC 2015, Indonesia is expected to compete competently with the other ASEAN countries. Thus, Indonesia can maintain its position, even surpass Singapore in terms of FDI.

However, as an archipelagic country, Indonesia faces problems with FDI distribution. Each region does not receive FDI inflows from abroad equally. This trend can be seen in Figure 1.

Figure 1. FDI Realization in Indonesia, 2000-2013

Source: Indonesia Investment Coordinating Board (2015)

As shown in Figure 1, the FDI inflows in Indonesia are likely to converge on Java. More than half of the total FDI flows into Java (58 percent), and the rest flows into other regions, such as Sumatera (14 percent), Kalimantan (12 percent), and the other regions (6 percent).

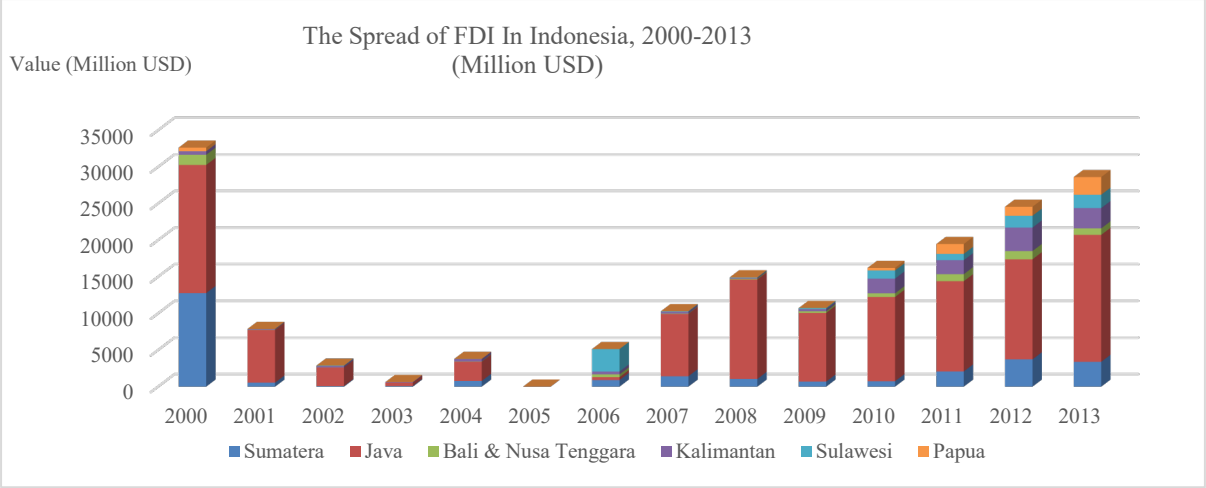

Figure 2. The Spread of FDI in Indonesia, 2000-2013

Source: Indonesia Investment Coordinating Board (2015)

The unequal distribution of FDI received by each region and the tendency of FDI inflows converging on a specific region are not the only problems that Indonesia needs to solve. Figure 2 shows that FDI realization is also erratic. There was a sharp decline in the FDI inflows from 2000 to 2003. However, interestingly enough, in 2004, when Indonesia held a presidential election, the trend of FDI in every region rose and then declined in 2005. This phenomenon can be explained by the research conducted by Jensen (2003), which states that regime change to democracy positively influences the inflow of FDI into a country. A similar phenomenon happened in Indonesia. Prior to 2004, the president and vice president were elected by the House of Representatives (*Dewan Perwakilan Rakyat,* abbreviated as DPR). In 2004, the president and vice president were directly elected by the people for the first time.

This political event recurred five years later. FDI increased from 2006 to 2008 and dropped in 2009 when Indonesia held the president and vice-president election. Thus, this political event will be observed if it impacts FDI flows into Indonesia. Jensen (2008) also agrees with the previous research and states that unstable political conditions and poor democratic institutions will have a negative effect on the flow of foreign investment into a country.

Apart from political conditions, economic openness is another interesting issue. According to the Global Competitiveness Report 2013-2014, the competitiveness index of the Indonesian domestic market ranked third with a score of 6.2 out of 7 while the Indonesian foreign market ranked fourth with a score of 6.4 out of 7. This implies that the Indonesian market has huge potential to attract both domestic and foreign investors

to invest in Indonesia. Economic openness will significantly affect the behavior of investors. Liavorgas and Skandalis (2012) reveal that the more open the economy of a country is, the higher its FDI inflows are, as it welcomes multinational companies to enter.

It would be interesting to observe the case of economic openness on a regional basis as some minority regions may still not be very open in terms of their economy. The causes of unequal FDI distribution across Indonesia are possibly not only political openness, but also economic openness of a region.

1.2. Research Purpose

The inception of the ASEAN Economic Community (AEC) has made the issue of foreign investment in Indonesia even more attractive. Looking at the increasing FDI in Indonesia in the recent years, a strategic plan is needed to enhance such an increase. This is because provinces and districts across Indonesia must compete with MEA countries.

The Indonesian government continues to strive to encourage an increase in FDI through various policies and regulations, including making revisions to the law on foreign investment, i.e. Law No. 1 of 1967, which was later amended to Law No. 25 of 2007 during the administration of President Susilo Bambang Yudhoyono. These various regulatory reforms have succeeded in increasing the amount of FDI received by Indonesia (see Figure 2) but, interestingly, FDI absorption across regions in Indonesia is uneven and still concentrates in Java.

Then a question arises regarding whether the FDI policies and regulations made by the central government have been effectively implemented by regional governments as the vanguard which should help increase the amount of FDI received by their respective regions and prevent FDI from concentrating only in certain areas in Indonesia as it was in the previous year. Or perhaps only a few regional heads during certain periods implemented such policies and regulations, but the next regional heads did not follow them up. If it proves true that regional governments have tried to carry out the mandate of the central government, it is regional economic openness that will become the next problem.

Based on the foregoing, this study aims to determine whether the disclosure of openness and the presidential election have an influence on FDI inflows in 30 provinces of Indonesia. To determine the influence of these variables, this study employs panel data regression with a fixed effect model. The results suggest that the level of openness and political variables, such as the presidential election, contribute to the

absorption rate of FDI inflows in the regions. The presidential election has a significantly negative effect on FDI inflows, while the democratic regime has a negative but insignificant effect. Furthermore, the variable openness has an effect that is positive but not significant on FDI inflows. Lastly, GRDP per capita, as a proxy of market size, has a significantly positive effect on FDI inflows.

II. Data Methodology

2.1. Data

The data used in this study were the annual panel data of 30 provinces in Indonesia for the period of 14 years, i.e. from 2000 to 2013. Although currently Indonesia has 34 provinces, this study only covers 30 provinces because the other four provinces just underwent decentralization in the years examined in this study, namely West Papua (2001), Riau Islands (2002), West Sulawesi (2004), and North Kalimantan (2012). Therefore, the data will not cover the entire period of the study.

The data were obtained from various sources, especially publications from several institutions. For example, the Province in Numbers (*Provinsi Dalam Angka*) data from Statistics Indonesia (*Badan Pusat Statistik*, abbreviated as BPS). We also obtained several data from the Indonesia Investment Coordinating Board (*Badan Koordinasi Penanaman Modal*, abbreviated as BKPM) and the General Election Commission (*Komisi Pemilihan Umum*, abbreviated as KPU). The data consisted of foreign direct investment (FDI), economic openness, GRDP per capita, a democratic regime dummy, and a presidential election dummy.

2.2. Methodology

This study employs a fixed effect model to capture the effect of economic openness and political variables in each region within the period of the study. The model used in this study refers to an earlier study conducted in 2006 by Banga. Banga (2006) conducted a study in some ASEAN and Asia-Pacific Economic Cooperation (APEC) countries, namely Bangladesh, China, Hong Kong, Taiwan, India, Indonesia, South Korea, Malaysia, Nepal, Pakistan, the Philippines, Singapore, Sri Lanka, Thailand, and Vietnam. Banga (2006) examined whether investment is an essential factor in ASEAN and APEC countries. The following model was proposed by Banga (2006):

FDIit = f [(Economic Fundamental)it-1, (Tariff Policies)it, (FDI Incentives)it, (Removal of Restrictions on FDI)it, (Bilateral Investment Agreements)dgct, ((Bilateral Investment Agreements)dct, (Regional Investment)it].....(1)

where *i* is the country, *t* is the time period 1980-81, 1981-82, ..., 1999-2000, *dgc* is a developed country, and dc is a developing country. Furthermore, in this study, Banga describes the economic fundamentals of some factors that are believed to prompt the foreign capital inflows in those countries. Those factors consist of the size of the market, market potential, labor costs, availability of experts, the cost of capital, infrastructures, the exchange rate, exchange rate stability, inflation, financial health, and economic stability, including political stability. Most of these factors are believed to have been examined and influence an increase in FDI. These factors were then modified and adjusted according to the local conditions in Indonesia. Thus, the following model was obtained in this study:

$$lfdi_{it} = \beta 0 + \beta 1 openness_{it} + \beta 2 marketsize_{it} + \beta 3 regime_{it} + \beta 4 election_{it} + \varepsilon t \quad (2)$$

where *lfdi* is the log of FDI per region per year in Indonesia in thousand USD, *openness* is the ratio of the amount of exports and imports to GRDP, *marketsize* is GRDP per capita per year in thousand rupiah, *regime* is the dummy variable for the democratic regime (0 = regime before democracy; 1 = a democratic regime), and *election* is a presidential election (0 = no election; 1 = election).

Various studies examine factors affecting FDI inflows into a country: economic openness and political variables. Research by Banga (2006) examines the relationship between economic fundamentals (consisting of market size, market potential, labor costs, availability of experts, the cost of capital, infrastructure availability, the real exchange rate, exchange rate stability, inflation, financial health, and economic stability, including political stability) and policies implemented by the government concerning the FDI inflows of a country. Banga (2006) examined 15 developing countries in South, East, and Southeast Asia and discovered that market size, availability of experts, and availability of infrastructures positively impact FDI inflows. Furthermore, Banga (2006) found out that labor and financial health proxied by the amount of debts owed negatively influence FDI. That is, the greater the market size of a country is, the greater the FDI inflows are. The other result indicates that the higher the labor costs are, the lower the FDI inflows of a country are. This study also shows that economic stability, inflation rates, exchange rates, as well as exchange rate stability do not affect FDI.

The effect of economic openness on FDI inflows has also been studied previously by Koojaroenprasit (2015) who revealed foreign investment inflows in ASEAN 6 (Indonesia, Singapore, Malaysia, the Philippines, Thailand, and Vietnam). Koojaroenprasit examined the effect of market size, labor wages,

economic openness, infrastructure availability, the inflation rate, the real exchange rate, the corporate tax rate, dummy crises in 1997–1998 and 2007–2008, and research & development on the inflows of foreign investment in ASEAN 6. In this study, Koojaroenprasit found out that market size and research & development have a positive effect on FDI inflows in ASEAN 6, while the level of corporate tax, labor wages, and economic openness have a negative effect on FDI. These findings are different from the results of the study conducted by Liavorgas and Scandalis (2012) which show a positive relationship between economic openness and FDI. In theory, economic openness can have both positive and negative effects on FDI. The impact of this economic openness depends on the type of investment made. If the investment is export-oriented, economic openness will have a positive effect on FDI, but if the investment is import-oriented, economic openness will have a negative effect on FDI. Then, Baek and Qian (2011) discovered that political risk and political violence greatly influence the investment decisions of foreign investors in both industrial and developing countries. In addition, Jensen (2003) also found it interesting that regime change appears to influence FDI inflows. Democratic governments have a very high positive impact on FDI, especially in developing countries.

III. Results and Discussion

3.1. Results

Before conducting a panel data regression analysis, the researchers performed a descriptive statistical analysis on the data from 30 provinces during the 2000–2013 period (Table 1). Results of the descriptive statistical analysis suggest that all provinces in Indonesia in 2000–2013 had an average FDI income of 1,700 million USD with the highest receipts of 9,322 million USD obtained by Central Java in 2013 and the lowest receipts of -286,298 thousand USD obtained by North Maluku in 2000, which means that foreign investment amounting to 286,298 thousand USD came out of North Maluku. In terms of the level of economic openness of each region, the average is 0.8146248 with the highest ratio of 1.98475 and the lowest ratio of 0.075004. Then, for GRDP per capita, it has an average of 7,109.749 thousand rupiah, with the highest value of 47,774.7 thousand rupiah and the lowest value of 1,767.58 thousand rupiah.

Table 1. Statistical Data for the Period of 2000–2013

Variable	N	Mean	Std. Dev.	Min.	Max.
FDI	420	1,700,370	2.63e+07	-286,298	9,322,171.70
Openness	420	0.8146	0.3714	0.0750	1.9847

Marketsize	420	7,109.749	6,187.325	1,767.585	47,774.7

In the last five years (2009–2013), the average FDI has decreased when compared to the previous years (2000–2008). In 2000–2008, the average FDI amounted to 2,289 million USD with the highest value amounting to 9,322 million USD and the lowest value amounting to -286,298 thousand USD, which means that foreign investment leaving the area is 286.298 thousand USD. The average FDI is much higher when compared to the average FDI in 2009–2013, which was 643,638.5 thousand USD with the highest value amounting to 7,124 million USD and the lowest value amounting to 200 thousand USD (Table 2).

Table 2. Statistical Data for the Periods of 2000–2008 and 2009–2013

Variable	2000–2008 Data				
	N	Mean	Std. Dev.	Min.	Max.
FDI	270	2,289,649	3.28e+07	-286,298	9,322,171.70
Openness	270	0.7714	0.3517	0.0750	1.8657
Marketsize	270	6,404.95	5,362.587	1,767.585	37,559.56
Variable	2009–2013 Data				
	N	Mean	Std. Dev.	Min.	Max.
FDI	150	643,638.5	1,230,934	200	7,124,880.71
Openness	150	0.8945	0.3897	0.2820	1.9847
Marketsize	150	8,384.202	7,283.199	2,582.899	47,774.7

The average level of economic openness in 2000–2008 was 0.7714 with the highest value amounting to 1.8945 and the lowest value amounting to 0.075. The average level of economic openness increased in 2009–2013 to 0.904 with the highest value amounting to 1.984 and the lowest value amounting to 0.282. The average GRDP per capita in 2000–2008 was 6,404.95 thousand rupiah with the highest value amounting to 37,599.56 thousand rupiah. The average GRDP per capita increased in 2009–2013 to 8,784.20 thousand rupiah with the highest value amounting to 47,774.7 thousand rupiah and the lowest value amounting to 2,585.56 thousand rupiah.

Table 3. Regression Results

	Model 1 Log FDI	Model 2 Log FDI
Openness	0.156	0.285
	(0.62)	(0.55)
Market Size	6.738***	6.260***
	(1.03)	(0.88)
Regime	-0.297	-0.407
	(0.41)	(0.32)
Election	-0.850**	-0.676**
	(0.36)	(0.31)
Extrapolation (=1)	-	-0.125
	-	(0.30)
Constant	-48.120***	-43.864***
	(8.80)	(7.53)
F-stat	23.93	20.55
Prob>F	0.0000	0.0000
R-squared	0.2419	0.2183
N	334	403

Notes: *10% significance level, **5% significance level, ***1% significance level

There are two models in this study. The first model uses original data and is not extrapolated and interpolated, while in the second model, there is missing data, filled using the method of extrapolation and interpolation. In general, the relationship between FDI, openness, GRDP per capita, democratic regimes, and implementation of a presidential election can be analyzed using two equations as follows:

Model 1 :

$lfdi_{it}$ = -48.120 + 0.256 openness + 6.738 marketsize – 0.297 regime – 0.850 election + ϵt..... (3)

Model 2 :

$lfdi_{it}$ = -43.864 + 0.285 openness + 6.260 marketsize – 0.407 regime – 0.676 election + ϵt..... (4)

Table 3 shows that economic openness affects positively, but not significantly, FDI in both models 1 and 2. This implies that the more open the economy of a region is, the higher the FDI inflows are. Liarvorgas (2012) stated that economic openness is one of the factors affecting the flow of foreign investment. This means that the higher the degree of economic openness is, the more excellent the opportunity for investors to expand their markets is.

While having a positive effect, the results also show that economic openness does not have a significant effect on FDI. These results concur with findings of the studies conducted by Chakrabarti (2001),

Globerman and Shapiro (2002), and Busse and Hefeker (2007). Asiedu (2002) stated that the impact of economic openness on FDI depends on the type of foreign investment. Horizontal FDI may be attracted to countries with higher trade barriers, which also protect the output of foreign investors in the local market against imports from competitors. Otherwise, a multinational company engaged in export-oriented investment, or vertical FDI, will invest in a more open economy as its trade barriers will increase transaction costs. Moreover, the existence of trade restrictions may also be associated with other forms of imperfection policies applied, especially in developing countries (Chakrabarti, 2001). Therefore, the type of the foreign investment will have a significant impact to economic openness. (Busse and Hefeker, 2007).

In the case of Indonesia, FDI inflows mostly belong to the category of vertical FDI, where foreign companies only need input from Indonesia for processing materials in their home country and reselling the products in Indonesia. High transaction costs and barriers to investing in Indonesia, particularly in the non-oil sector, make economic openness insignificant. However, the government has revised the foreign investment law, which is one way to improve Indonesia's investment climate. Nevertheless, there is no significant improvement in terms of ease of investment for investors to invest in Indonesia.

According to the Ease of Doing Business (EODB) Survey conducted by the World Bank-International Finance Corporation (World Bank-IFC) in 2013, Indonesia still ranked 128th. This rank puts Indonesia under ASEAN-6 countries, such as Singapore (1st), Malaysia (12th), and Thailand (18th). Indonesia did manage to get a higher rank in 2016, i.e. above 109th, but it is still relatively poor (EODB, 2016). This is because other ASEAN countries also experienced a rapid increase, such as Thailand (49th), Vietnam (90th), and the Philippines (103rd). At the same time, Singapore remained in the first position and Malaysia ranked 18th.

Insignificant economic openness can be seen from the value of export and import through seaports concentrated in a few large ports. This problem makes the distribution of export and import volumes in each region unequal. Table 2 in the appendix shows that Port of Tanjung Priok, Port of Dumai, Port of Tanjung Perak, Port of Bontang, and Port of Belawan contribute the highest export. Meanwhile, there are several ports with export value of less than half of the export value of the five ports. Similar findings are also obtained for import (see Table 3), with Port of Tanjung Priok still in the first position, followed by Port of Tanjung Perak, Port of Cilacap, Port of Balikpapan, and Port of Merak. The geographical conditions of each region are different, which make not all areas have a seaport, for example areas that are far from the sea or areas that are close to the sea but the water conditions do not allow such areas to build a port. As a result, such areas do not contribute to the total value of export and import through seaports.

Table 2. Export Value According to Province Main Port (Million USD)

Province	Main Port	2009	2010	2011	2012	2013
Aceh	Blang Lancang (Arun)	1,035.00	1,326.30	1,406.30	1,197.30	930.40
North Sumatera	Belawan	5,369.00	7,429.00	10,057.70	8,871.90	7,982.30
West Sumatera	Padang/Teluk Bayur	1,344.30	2,214.60	3,030.00	2,362.90	2,208.60
Riau	Dumai	8,993.70	11,770.90	16,485.30	15,516.80	14,195.70
South Sumatera	Palembang-Plaju	395.30	500.30	501.40	642.40	4,036.80
South Sumatera	Musi River	1,557.50	2,963.60	4,489.70	3,629.90	2,931.10
Lampung	Panjang	2,258.70	2,467.40	3,222.60	3,698.40	2,096.70
The Special Capital Region of Jakarta	Tanjung Priok	28,165.40	34,237.80	40,079.10	42,697.30	41,708.50
West Java	Balongan	148.70	345.30	511.10	421.50	425.80
Banten	Merak	567.40	790.80	917.10	634.00	825.20
Central Java	Tanjung Emas	2,850.80	3,663.80	4,166.80	4,423.90	4,697.30
Central Java	Cilacap	208.20	199.40	511.50	213.20	622.40
East Java	Tuban	683.70	1,823.30	2,355.40	328.80	111.70
East Java	Tanjung Perak	9,702.0	12,386.50	14,608.90	13,228.40	12,649.80
West Nusa Tenggara	Bima	1,243.90	1,994.20	1,136.30	596.20	399.90
West Kalimantan	Pontianak	393.80	580.90	1,260.80	964.10	893.50
South Kalimantan	Banjarmasin	3,117.90	3,499.30	4,899.30	4,654.70	4,318.90
South Kalimantan	Kotabaru	2,443.40	2,840.40	4,717.70	4,821.80	4,162.80
East Kalimantan	Balikpapan	2,177.80	2,912.90	3,274.40	3,688.10	3,066.90
East Kalimantan	Samarinda	2,286.60	4,460.20	6,245.80	6,025.80	5,366.90
East Kalimantan	Bontang	7,950.00	9,893.00	17,079.80	13,577.90	11,566.60
North Sulawesi	Bitung	396.00	373.60	744.00	941.80	665.40
South Sulawesi	Ujung Pandang	713.20	867.10	660.50	547.90	605.70
South Sulawesi	Malili	555.10	1,429.60	1,221.30	949.00	924.00
South East Sulawesi	Kolaka	3.10	7.40	38.40	108.00	101.80
South East Sulawesi	Pomalaa	279.10	454.50	720.00	486.30	307.40
Maluku	Ambon	69.50	130.40	134.90	166.70	134.30
North Maluku	Ternate	167.60	275.00	487.20	368.90	569.90

Papua	Amamapare	3,857.50	4,885.40	3,528.70	1,996.80	2,609.30

Source: Statistics Indonesia (2016)

Table 3. Import Value According to Province Main Port (Million USD)

Province	Main Port	2009	2010	2011	2012	2013
North Sumatera	Belawan	2,484.20	3,296.30	4,606.50	4,775.60	4,826.3
Riau	Dumai	265.90	504.70	1,175.20	1,084.90	1,064.5
South Sumatera	Boom Baru	205.30	359.30	552.20	506.40	551.30
Lampung	Kota Agung	656.90	866.70	1,247.80	1,716.20	1,552.9
The Special Capital Region of Jakarta	Tanjung Priok	40,917.00	60,071.50	77,260.80	81,102.90	77,412.0
Banten	Merak	3,719.70	5,096.10	6,904.50	6,463.00	6,631.8
Banten	Cigading	1,744.70	2,507.60	3,549.80	3,961.70	4,059.0
Central Java	Tanjung Emas	2,704.60	4,385.70	4,904.80	5,103.10	5,704.7
Central Java	Cilacap	3,623.10	5,233.10	8,093.30	8,869.30	10,031.1
East Java	Tanjung Perak	9,309.30	12,475.20	15,721.70	16,430.70	17,463.6
Bali	Benoa/Loloan	637.10	828.10	911.80	41.90	36.90
West Nusa Tenggara	Bima	175.30	287.60	306.80	263.70	171.90
East Nusa Tenggara	Waingapu	4.70	5.80	12.00	41.40	19.00
West Kalimantan	Pontianak	85.60	131.10	207.60	470.20	404.50
South Kalimantan	Kota Baru	660.20	1,419.40	2,593.70	2,752.70	2,478.1
East Kalimantan	Balikpapan	3,908.80	5,042.80	5,572.60	6,122.00	7,228.0
East Kalimantan	Samarinda	255.50	486.20	513.10	543.70	439.70
East Kalimantan	Tanjung Sangata	454.20	334.50	742.50	1,135.50	1,008.2
North Sulawesi	Bitung	19.50	70.80	144.40	122.60	106.50
Central Sulawesi	Pantoloan	0.30	11.80	11.90	2.70	15.50
South Sulawesi	Ujungpandang	422.80	688.80	1,072.10	872.30	876.70
South Sulawesi	Malili, Sulawesi	144.60	266.80	292.40	308.50	313.10
Maluku	Ambon	92.40	312.30	340.90	423.80	354.70
Papua	Amamapare	793.80	921.70	1,099.20	1,020.40	503.90

Source: Statistics Indonesia (2016)

On the other hand, per capita income shows different impacts on FDI. Per capita income positively and significantly impacts FDI at the confidence level of 1 percent. GRDP per capita is a proxy of market size. The result shows that the larger the market size of a region is, the greater the FDI inflows into the region are. This is consistent with the initial hypothesis. According to Banga (2006), market size has a positive and significant effect on FDI. Koojaroenprasit (2015) confirms that market size (GRDP per capita) would be significant at 1 percent of the FDI inflows. Thus, market size, which is indicated by GRDP per capita, is essential to attract foreign investment (Chakrabarti, 2001). Asiedu (2002) adds that investors will gain more returns when investing in a larger market (market size) with high income per capita. This indicates that the market size of regions in Indonesia can potentially attract foreign investors.

Political variables proxied by the democratic regime and the holding of elections have different directions and significance. The democratic regime has a negative effect, but it is not significant. This result contrasts with the findings of the research conducted by Jensen (2008). Such an effect may result from the fact that society uses various ways to express aspiration for democracy, which sometimes lead to conflict. Therefore, investors become more concerned about making an investment.

Different results are obtained for the election variable. Findings of the study show that it has a negative and significant effect on FDI at the confidence level of 5 percent. According to Jensen (2008), political events have a negative effect on FDI inflows. In addition, MIGA (2010) stated that investors who tend to avoid markets with a relatively high political risk due to political instability will tend to reduce the profitability of foreign investment. Uncertainty about the prospective head of government also encourages pessimism among investors, which determines their investment patterns in Indonesia. This is confirmed by Busse and Hefeker (2007) in their research. They reveal that investors are very sensitive to changes in political stability and a change of government. Moreover, Jensen (2008) adds that the democratic institution is also one of the factors triggering low FDI inflows into a country. As already known, the political conditions of Indonesia near an election will be unstable due to the enthusiasm of party members in each region, and it often causes commotion or even more conflict. Some of these events entice foreign investors to invest in Indonesia.

IV. Conclusions

4.1. Recommendations

The level of economic openness has a positive effect, but it does not significantly affect FDI inflows. This differs from the initial hypothesis of the study, but similar results are obtained by the research conducted by Busse and Hefeker (2007) and Globerman and Shapiro (2002). Seim (2009) explains that the geographical position, geographical conditions, and possible income levels correlate with the degree of economic openness. There is also a tendency that a country with larger market size will have lower economic openness as a result of higher income levels. In addition, high export and import through seaports is a contributing factor. This is because seaports are not evenly distributed across all areas, and trading mostly takes place at big seaports, like Port of Tanjung Priok, Port of Tanjung Perak, and Port of Bontang. This study also proves that income per capita, which is a proxy of market size, significantly affects the FDI inflows of a region. Lastly, the political variables, which in this study are represented by the democratic regime and the general election, have two different effects. The democratic regime has a negative effect, but it does not significantly affect FDI inflows. In contrast, the presidential election has a positive and significant effect on FDI inflows.

4.2. Acknowledgements

The data used in this study is the annual panel data of 30 provinces in Indonesia for the period of 14 years, i.e. from 2000 to 2013. Although currently there are 34 provinces in Indonesia, this study only covers 30 provinces because the other four provinces just underwent decentralization in the years examined in this study, namely West Papua (2001), Riau Islands (2002), West Sulawesi (2004), and North Kalimantan (2012). Therefore, the data will not cover the entire period of the study. The variables of the study consist of foreign direct investment (FDI), economic openness (sum of exports and imports per GRDP), gross regional domestic product (GRDP) per capita, a democratic regime dummy, and a presidential and vice-presidential election dummy.

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