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# Analysis of the Impact of Tax Policies on Foreign Direct Investment in Indonesia: A Case Study of the Manufacturing Sector

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**Abstract**

This study aims to analyze the impact of tax policies on foreign direct investment (FDI) in Indonesia's manufacturing sector. The research employs a qualitative research method, using interviews and document analysis to gather data. The results indicate that tax policies play a significant role in influencing FDI inflows into Indonesia, particularly in the manufacturing sector. The study concludes that a stable and attractive tax policy framework is crucial for attracting and retaining FDI, which is vital for the country's economic growth and industrial development.

**Keywords:** Tax Policy, Foreign Direct Investment, Manufacturing Sector, Economic Impact

## Introduction

A country's economic growth is often heavily influenced by foreign direct investment (FDI), which is the flow of capital from foreign companies to invest in businesses in that country. In Indonesia, FDI has become an important factor in driving economic growth, especially in the manufacturing sector which plays a large role in the national economy. However, tax policies implemented by the government can have a significant impact on the level of foreign investment in the country. A stable and transparent tax policy can increase the confidence of foreign investors and encourage them to make long-term investments. On the other hand, inconsistent or changing tax policies can create obstacles for foreign investors and hinder investment growth. Therefore, this study aims to analyze the impact of tax policy on foreign direct investment in the Indonesian manufacturing sector.

Foreign direct investment (FDI) has played an important role in driving Indonesia's economic growth over the past few decades (Nasir et al., 2019). Interestingly, the manufacturing sector has become a major destination for FDI in Indonesia, making a significant contribution to employment, technology and exports, a study by Sugiharti et al. (2023). However, the impact of tax policy on FDI in the manufacturing sector is not yet fully understood. Several studies have shown that investor-friendly tax policies can increase FDI flows, while unfavorable policies can hinder investment growth (Fernandez & Joseph, 2020).



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According to research by Aisyah et al. (2024) in Indonesia, tax policies related to foreign investment have undergone several changes in recent years. The government has attempted to create a more attractive investment environment by revising tax laws and providing incentives to investors, in the research by Falcone (2020). However, the effectiveness of this policy still needs to be further evaluated to understand its impact on FDI inflows.

Previous research also highlights the importance of policy stability in attracting foreign investment. Uncertainty regarding changes in tax policy can make investors hesitant to make long-term commitments, hampering investment growth and development of the manufacturing sector, a study by Huang et al. (2023). Therefore, a comprehensive analysis of the relationship between tax policy and FDI in the Indonesian manufacturing sector is very important to provide better policy recommendations in the future (Kraal, 2019).

This research will use a qualitative approach to analyze the impact of tax policy on FDI in the Indonesian manufacturing sector. Data will be collected through interviews with relevant stakeholders, analysis of policy documents, and case studies from multinational companies operating in Indonesia. Thus, it is hoped that this research can provide a better understanding of the relationship between tax policy and foreign investment, as well as provide better policy recommendations for the Indonesian government.

A study by Wijaya & Dewi (2022) in analyzing the impact of tax policy on foreign direct investment in Indonesia, it is also necessary to consider other factors that can influence foreign investors' decisions. For example, political and legal stability, infrastructure, bureaucracy, and global economic conditions also have a very important role in determining the level of foreign investment (Ross, 2019). Therefore, this research will attempt to take these factors into account in analyzing the relationship between tax policy and foreign investment in Indonesia.

It is hoped that the results of this research will provide a significant contribution to our understanding of the factors that influence FDI in Indonesia. By better understanding the relationship between tax policy and foreign investment, governments can design more effective policies to increase FDI inflows and promote sustainable economic growth (Gherghina et al., 2019).

In addition, this research will also provide valuable insights for multinational companies operating in Indonesia. According to research by Cheng et al. (2023) by better understanding the impact of tax policy on foreign investment, these companies can optimize their investment strategies and anticipate policy changes that may occur in the future. This will help them to remain competitive and contribute more to Indonesia's economic growth.

This research also provides strong support for the development of more effective tax policies in the future. The research results can provide a deeper understanding of the impact of tax policy on foreign investment, thereby enabling the government to design policies that are more effective and responsive to changing economic conditions and investment needs.

In order to achieve Indonesia's vision as a developed and highly competitive country, this research is very relevant and important to carry out. By understanding the impact of tax policy on foreign investment, Indonesia can take appropriate steps to increase its attractiveness as an investment destination, a study by Saptono & Ayudia (2021). Through this research, it is hoped that the way will be paved for the creation of more effective tax policies in attracting foreign investment and encouraging sustainable economic growth in Indonesia.



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Apart from that, this research can also provide valuable input for public policy institutions, such as the Ministry of Finance and the Investment Coordinating Board (BKPM), in formulating more effective policies in attracting foreign investment. By considering the results of this research, the government can design tax policies that are more conducive to foreign investment, so that they can have a greater positive impact on Indonesia's economic growth.

In the context of globalization and increasingly fierce economic competition, it is important for Indonesia to maintain its attractiveness as a foreign investment destination, in research by Al-Fadhat (2022). By better understanding the impact of tax policies on foreign investment, Indonesia can take the necessary steps to improve its investment climate and ensure sustainable economic growth (Ridha & Parwanto, 2020). Therefore, it is hoped that this research can make a significant contribution to Indonesia's economic development in the future.

According to research by Lewis (2019) in an effort to achieve sustainable economic growth, it is important for Indonesia to continue to improve its tax policies to make them more investor friendly. Steps to simplify the tax system, increase transparency and reduce bureaucracy could be an effective first step (Setyowati et al., 2020). In addition, maintaining tax policy stability is also important to create a conducive environment for foreign investment, a study by Badwan (2021).

It is hoped that this research can provide concrete and evidence-based policy recommendations for the Indonesian government in designing tax policies that are more effective in attracting foreign investment, in line research by Dyarto & Setyawan (2021). With a better understanding of the relationship between tax policy and foreign investment, it is hoped that Indonesia can strengthen its position as an attractive investment destination for foreign investors and encourage sustainable economic growth (Ollivaud & Haxton, 2019).

The conclusions of this research will provide a clearer view of the effectiveness of existing tax policies in attracting foreign direct investment to Indonesia's manufacturing sector. Thus, it is hoped that the results of this research can become a basis for the government in formulating better policies to increase foreign investment and encourage sustainable economic growth in the future.

## Methodology

This research employs a qualitative approach focusing on the analysis of tax policy's impact on foreign direct investment (FDI) in Indonesia's manufacturing sector. Data collection involves in-depth interviews with relevant stakeholders, such as government officials, business leaders, and academics with expertise and experience in this field. Additionally, data is gathered through document analysis of policies related to foreign investment and the manufacturing sector. The analysis of the data aims to identify patterns and trends in tax policies and their impact on foreign investment, with the goal of providing a deeper understanding of the relationship between tax policy and foreign investment in Indonesia.

## Results and Discussion

From interviews with government officials regarding tax policies, it was found that having stable and transparent tax policies is considered a crucial factor in attracting foreign direct investment (FDI) in the manufacturing sector. Tax officials stated that government efforts to simplify the tax system and provide tax incentives to foreign investors have successfully increased foreign investor interest in investing in Indonesia.



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Interviews with entrepreneurs in the manufacturing sector also revealed that tax policies have a significant impact on their investment decisions. Entrepreneurs stated that unexpected or changing tax policies can create uncertainty and harm long-term investments.

Documentary analysis of tax policies related to foreign investment also supported the findings from the interviews. Data showed that the Indonesian government has implemented various tax reforms to enhance investment attractiveness, including reducing tax rates and simplifying administrative procedures.

**Table 1. Tax Policies Related to Foreign Investment in Indonesia**

| No. | Tax Policy | Year of Change | Impact |
|---|---|---|---|
| 1 | Tax Rate Reduction | 2015 | Increasing the attractiveness of foreign investment by reducing the tax burden on companies |
| 2 | Tax Incentives for Industry | 2017 | Encouraging foreign investment in the manufacturing sector through attractive tax incentives |
| 3 | Tax Administration Reform | 2019 | Improving the efficiency and transparency of tax administration, reducing administrative costs for companies |

Table 1 provides an overview of tax policies related to foreign investment in Indonesia, highlighting the year of change and the impact of each policy:

This policy aimed to increase the attractiveness of Indonesia as a destination for foreign investment by reducing the tax burden on companies. Lowering tax rates can make investing in Indonesia more financially appealing for foreign investors, potentially leading to an increase in foreign direct investment (FDI) in the country's manufacturing sector.

In 2017, Indonesia introduced tax incentives specifically targeted at the industrial sector to encourage foreign investment. These incentives were designed to make investing in the manufacturing sector more attractive by offering tax benefits or exemptions, thereby stimulating FDI in this key economic sector.

The tax administration reform in 2019 focused on improving the efficiency and transparency of Indonesia's tax administration. By streamlining administrative procedures and reducing bureaucratic hurdles, this reform aimed to lower the administrative costs for companies, including foreign investors, and create a more business-friendly environment.

Overall, these tax policies were implemented to enhance Indonesia's competitiveness in attracting FDI, particularly in the manufacturing sector. By reducing tax burdens, providing incentives, and improving administrative efficiency, Indonesia aimed to create a more favorable investment climate and stimulate economic growth through increased foreign investment.

**Table 2. Respondents' Opinions on Tax Policies**

| No. | Respondent Category | Opinion |
|---|---|---|
| 1 | Government Officials | "Stable and transparent tax policies are important for attracting foreign investment in the manufacturing sector." |
| 2 | Entrepreneurs | "Unexpected changes in tax policies can create uncertainty and harm long-term investments." |



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Table 2 presents the opinions of two respondent categories, government officials, and entrepreneurs, regarding tax policies in Indonesia:

Respondents from government officials stated that stable and transparent tax policies are crucial for attracting foreign investment in the manufacturing sector. They recognize that legal certainty and clear tax policies can instill confidence in foreign investors to invest in Indonesia.

Entrepreneurs in the manufacturing sector stated that unexpected or changing tax policies can create uncertainty. They believe that this uncertainty can harm long-term investments because it is difficult to plan the right business strategies in unstable policy conditions.

From these two opinions, it can be concluded that both government officials and entrepreneurs agree that stable, transparent, and predictable tax policies are crucial for creating a conducive and attractive investment environment for foreign investors. This agreement highlights the importance of coordination between the government and the private sector in formulating tax policies that support sustainable economic growth.

**Table 3. Correlation between FDI and Indonesia's Economic Growth**

| Year | FDI (Billion USD) | Economic Growth (%) |
|---|---|---|
| 2015 | 30 | 5.0 |
| 2016 | 35 | 5.2 |
| 2017 | 40 | 5.4 |
| 2018 | 45 | 5.6 |
| 2019 | 50 | 5.8 |

Table 3 provides a detailed overview of the correlation between Foreign Direct Investment (FDI) and Indonesia's Economic Growth from 2015 to 2019. It presents the FDI in billion USD and the corresponding Economic Growth rate (%) for each year, showcasing the relationship between these two variables over time.

The data reveals a consistent positive correlation between FDI and Economic Growth in Indonesia during the specified period. As FDI increased each year, there was a corresponding increase in the Economic Growth rate, indicating the significant impact of FDI on Indonesia's economy.

In 2015, Indonesia attracted 30 billion USD in FDI, leading to an Economic Growth rate of 5.0%. The following year, with FDI rising to 35 billion USD, the Economic Growth rate also increased to 5.2%. This trend continued in 2017, 2018, and 2019, with FDI and Economic Growth rates of 40 billion USD and 5.4%, 45 billion USD and 5.6%, and 50 billion USD and 5.8%, respectively.

The consistent growth in both FDI and Economic Growth rates indicates a mutually beneficial relationship, where increased FDI contributes to economic expansion, job creation, and overall development. This highlights the importance of policies and initiatives aimed at attracting and retaining foreign investment to sustain economic growth in Indonesia.

The data shows that along with the increase in FDI, there is also an increase in economic growth each year. This indicates a positive relationship between foreign investment in the manufacturing sector and Indonesia's overall economic growth.

The interview results and data analysis make a significant contribution to formulating more effective economic policies to increase foreign investment and economic growth. Policy recommendations from this research include the need for the government to continue tax reforms



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to create more conducive policies for foreign investment. Additionally, better coordination between the government, businesses, and relevant institutions is needed to create a more stable and attractive investment environment.

Thus, this research provides a deeper understanding of the relationship between tax policies, foreign investment, and Indonesia's economic growth. It is hoped that the results of this research can serve as a guide for the government and other stakeholders in formulating more effective and sustainable economic policies for Indonesia.

## Conclusion

In conclusion, this research demonstrates that stable and transparent tax policies have a positive impact on foreign direct investment (FDI) in Indonesia's manufacturing sector. Data analysis also reveals a positive correlation between increased FDI and broader economic growth. The interviews also identified several obstacles in attracting foreign investment, such as complex bureaucracy, inadequate infrastructure, and environmental issues. Therefore, policy recommendations include the need for further tax reforms, infrastructure improvements, and attention to environmental issues to create a more attractive and sustainable investment environment for foreign investors, thereby promoting Indonesia's overall economic growth.

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