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Uneven Gains from Globalization: How FDI Boosts Growth Amid Trade and Labor Market Challenges in Indonesia and Thailand

Utama Ahmed Dima[1], Mutmainah[2], Muhammad Meidy Nur Hafidz[3], Haifa Lestari[4]

[1,2,3,4]Universitas Lambung Mangkurat, Banjarmasin

Corresponding author: utamadima@ulm.ac.id

Abstract

This study investigates the long-run impact of Foreign Direct Investment (FDI) on economic growth in Indonesia and Thailand between 1996 and 2023, utilizing a Vector Error Correction Model (VECM) framework. The results confirm that FDI plays a substantial and positive role in promoting economic growth in both countries, consistent with endogenous growth theories emphasizing capital accumulation, technology transfer, and productivity enhancement. In Indonesia, FDI is found to significantly support economic expansion over the long term. However, trade openness and labor force participation have an adverse effect on growth, which may reflect structural challenges such as reliance on low-value-added exports and inefficiencies in labor market absorption. In Thailand, FDI also contributes positively to economic performance, although the effect is comparatively more modest. Unlike Indonesia, trade openness in Thailand is associated with stronger growth, suggesting effective integration into global markets and improved competitiveness. Yet, the labor force variable shows a negative relationship with growth, indicating possible mismatches in labor supply and demand or underutilization of the workforce. These findings highlight the importance of structural reforms—particularly in trade policy and labor market efficiency—to ensure that the benefits of FDI are fully realized. Future studies are encouraged to incorporate additional factors such as institutional quality and financial development to enrich the understanding of growth mechanisms in emerging economies.

Keywords: Foreign Direct Investment, Economic Growth, Indonesia, Thailand, VECM

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INTRODUCTION

In the modern global business environment, every business entity strives to secure profits, while investors seek appropriate ventures for their capital. This interdependence between investors and entrepreneurs has become increasingly common, especially as open international markets and technological advances have diminished geographical barriers. One crucial channel for capital movement across borders is Foreign Direct Investment (FDI), defined as investment from a foreign entity into a host country's economy (UNCTAD, 2007). FDI plays a pivotal role in emerging economies, providing essential capital that domestic investors often cannot fully supply. This inflow of foreign capital not only finances production but also contributes to the host country's broader economic development.

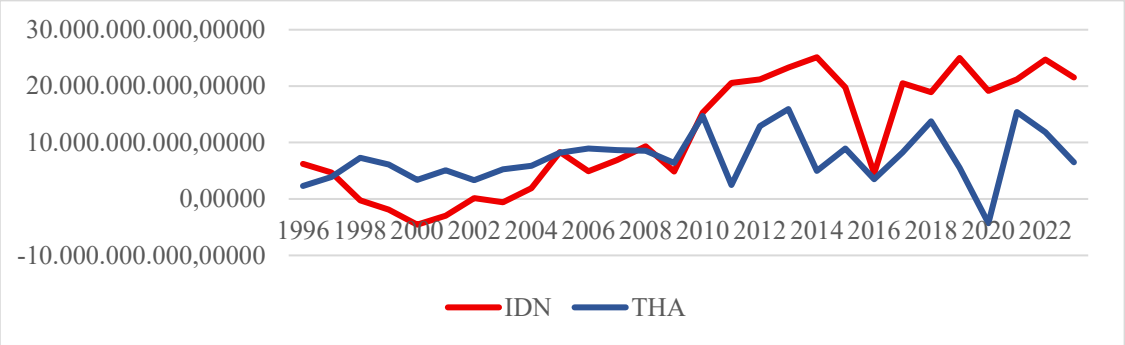
Several studies have emphasized that FDI positively influences economic growth by bringing in financial resources, new technologies, and management expertise. For this reason, many governments actively promote FDI through policy incentives such as tax reductions, import duty exemptions, and infrastructure subsidies (Chaudhry et al., 2013). For investors, understanding these incentives and the regulatory climate is essential for making strategic decisions (Demirbag et al., 2007). Moreover, the inflow of FDI has the potential to generate positive externalities, such as job creation, improvements in human capital, and the diffusion of advanced technology to local industries (Mencinger, 2003). According to neo-classical and endogenous growth theories, FDI contributes to economic growth either by increasing direct capital investment or through technological spillovers that enhance productivity and foster innovation (Nair-Reichert & Weinhold, 2001).

Historically, Southeast Asia has experienced dramatic shifts in economic performance, particularly during the 1997–1998 Asian financial crisis, when many countries, including Indonesia and Thailand, faced severe economic downturns and required assistance from the International Monetary Fund (IMF). However, over the past two decades, these nations have demonstrated significant resilience and economic recovery. Southeast Asia has emerged as one of the most promising regions for foreign investors, characterized by robust GDP and productivity growth that, since 2000, has consistently outpaced that of many developed economies (Rankine, 2019). Factors such as macroeconomic flexibility, a growing industrial sector, increased integration with the global economy, and large, young populations have contributed to the region's continued attractiveness for investment (Alston et al., 2018).

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Figure 1. Foreign Direct Investment Overview in Indonesia and Thailand



Source: Author's creation

Data from the World Bank further illustrates the disparities and trends in FDI inflows within Indonesia and Thailand. While foreign direct investment (FDI) inflows to Indonesia have exhibited a degree of volatility over time, they have generally remained higher than those observed in Thailand. During the mid-1990s, Thailand attracted greater FDI inflows compared to Indonesia. However, in the aftermath of the 1998 financial crisis, Indonesia experienced a marked improvement in FDI performance, eventually surpassing Thailand. Despite intermittent fluctuations, Indonesia has maintained a relatively stronger FDI position in the region in subsequent years.

LITERATURE REVIEW

The literature review in this research provides an extensive overview of prior empirical studies investigating the relationship between Foreign Direct Investment (FDI) and economic growth across different regions and economies. The review begins by acknowledging that there remains no universal consensus among scholars regarding the nature and significance of this relationship. To organize the diverse findings, the chapter is divided into sections based on whether previous research supports a positive, significant impact of FDI on economic growth, or conversely, finds little to no meaningful relationship. Additionally, it highlights studies conducted in countries relevant to the present research.

The first section presents several studies that affirm the significant and positive role of FDI in driving economic growth. For instance, Alzaidy et al. (2017) employed ARDL time series analysis for Malaysia and confirmed that FDI had a positive effect on long term, especially when mediated by a well-developed financial sector. Sothan (2017)

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similarly found a significant long-term effect of FDI on Cambodia's economic growth, although this relationship was unidirectional. Other examples include findings from Singapore (Alkapler & Adil, 2017), China (Chaudhry et al., 2013), Pakistan (Tahir, Khan & Shah, 2015), and Central Asian republics (Gürsoy et al., 2013), where empirical evidence consistently pointed to either one-way or two-way causality linking FDI to economic growth. Complementary studies in Central and Eastern Europe by Gherghina et al. (2019) and Vojtovic et al. (2019) also demonstrated that FDI positively influences economic performance, with institutional factors and capital market development further strengthening this relationship. Notably, in Mauritius, Blin & Ouattara (2009) reported significant long-term benefits from FDI, especially when combined with targeted policy incentives for emerging sectors such as information technology.

In contrast, a separate body of research concludes that FDI does not universally deliver a significant positive effect on economic growth. Naveed & Shabirr (2006), analyzing data from 23 developed countries, found that while trade openness significantly influenced economic growth, FDI did not exhibit a similar effect. Likewise, Alvarado et al. (2017) argued that FDI's benefits are largely confined to high-income nations, and its impact on upper-middle-income Latin American economies remained statistically insignificant. Carbonell & Werner (2018) arrived at a similar conclusion for Spain, despite substantial FDI inflows during the studied period. Their findings advise policymakers against over-prioritizing foreign investment as a growth strategy. In line with this, Bacic et al. (2004) examined 11 Central and Eastern European countries undergoing economic transitions and found no significant contribution of FDI to growth. This was attributed to the predominance of brownfield investments, where foreign funds are channeled into acquiring existing assets rather than creating new productive capacities.

Collectively, these studies underscore the complexity and contextual nature of FDI's role in economic development. While several emerging and transitioning economies have successfully leveraged FDI inflows to enhance their growth trajectories, others have not realized similar benefits, often due to structural, institutional, or sectoral limitations. The literature indicates that the success of FDI in stimulating growth depends not only on the quantity of capital inflows but also on the quality of domestic institutions, policy frameworks, financial sector development, and the alignment of investment with productive sectors. This nuanced understanding informs the foundation of the current research, which aims to explore the dynamics of FDI and economic growth within the context of its selected sample countries, where such debates remain ongoing.

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THEORETICAL FRAMEWORK

The theoretical framework is constructed based on established theories that provide a foundation for formulating hypotheses. It serves as a conceptual blueprint that guides researchers in identifying, investigating, and analyzing problems and acts as a reference for structuring the research process (Adom et al., 2018). This study adopts several interconnected theories to deepen the understanding of the examined phenomena. The elaboration of these theories is presented in the following subsections.

Endogenous Growth Theory

Endogenous Growth Theory posits that economic growth is fundamentally driven by internal factors such as the accumulation of capital, human resources, and, most importantly, technological innovation. This theory evolved from the Neoclassical Growth Model formulated by Solow (1956), which conceptualizes a production function dependent on two primary inputs: capital and labor. In the neoclassical model, technology functions as an exogenous factor influencing economic growth, as reflected in the production function:

$$Y=F(K,L)Y = F(K, L)Y=F(K,L)$$

Where *Y* denotes output (economic growth), *K* represents capital, *L* signifies labor, and *F* symbolizes the technological factor external to both capital and labor.

Endogenous Growth Theory extends this framework by incorporating technological progress as an outcome of deliberate economic activities such as research and development (R&D). FDI, as an international capital inflow, typically brings advanced knowledge and technology from developed to developing countries. This transfer enriches the host country's technological capabilities and supports the argument for using endogenous growth as the theoretical underpinning for this study.

Romer (1990) argued that technological change, fostered through R&D activities, has a direct and substantial influence on economic growth. The theory also suggests that economies with greater human capital tend to grow faster due to a more rapid absorption and adaptation of technological innovations. Thus, even countries with large populations but lower levels of development can leverage international trade and FDI to enhance their economic growth prospects.

Additionally, growth arises from firms' efforts to gain competitive advantages by continuously innovating their products and processes. Aghion and Howitt (1992)

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introduced the concept of "creative destruction," whereby innovation-driven competition compels firms to replace obsolete technologies with new ones, spurring ongoing economic progress. Barro and Sala-i-Martin (2003) further elaborated on the role of capital, labor, and technology as critical drivers of long-term growth, emphasizing policy implications for both developed and developing nations to encourage sustained FDI inflows and foster domestic innovation ecosystems.

Theory of International Capital Flows

The Theory of International Capital Flows addresses the movement of capital across national boundaries and its implications for economic development, particularly in capital-scarce developing economies. According to Miller (1968), capital typically flows from countries with lower marginal returns on capital to those offering higher returns. However, these flows are not solely determined by productivity levels but are also influenced by factors such as institutional quality, capital market imperfections, economic openness, and financial system development.

Feldstein (1999) noted that advancements in information technology, computing, and communication have facilitated the globalization of capital markets, enabling investors and multinational firms to channel funds abroad with reduced transaction costs. FDI, as a form of international capital flow, benefits both investors and host countries by promoting production efficiency, diversifying business risks, and expanding access to broader markets.

Moreover, Akhtaruzzaman (2019) emphasized that disparities in institutional quality and governance structures between rich and poor countries substantially influence capital flow patterns. While GDP per capita remains a primary determinant of capital inflows, the presence of institutional friction and varying levels of economic openness also critically shape international capital movements.

Economic Growth

Economic growth represents the dynamic process of increasing a country's productive capacity, typically measured by changes in output, industrial composition, and capital structure. Shearer (1961) viewed economic growth as a product of human behavior, institutional evolution, and societal motivations to progress.

Aghion and Howitt (2009) identified four paradigms of economic growth:

a) Neoclassical Growth Model

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Growth originates from capital accumulation and labor inputs within a production function framework, supplemented by investment dynamics and capital depreciation.

b) AK Model

This model integrates capital accumulation and technological advancement, proposing that sustained high growth requires a proportion of GDP to be allocated to scientific research and technological application.

c) Product-Variety Model

Economic growth is driven by continuous innovation, leading to product differentiation and productivity gains. R&D investments enable firms to secure temporary monopolistic advantages, thereby attracting further capital inflows.

d) Schumpeterian Model

Grounded in the principle of "creative destruction," this paradigm underscores how ongoing innovation replaces outdated products and processes, thereby perpetuating economic growth through increased turnover and modernization.

Foreign Direct Investment (FDI)

The United Nations Conference on Trade and Development (UNCTAD, 2007) defines FDI as long-term investments involving a lasting interest and significant control by a foreign entity over a domestic enterprise. FDI comprises three main components:

a) Equity Capital: Share acquisitions in foreign firms.
b) Reinvested Earnings: Profits retained in the host country rather than repatriated.
c) Intra-Company Loans: Intercompany financial transactions between parent firms and subsidiaries.

Froot (1993) characterized FDI as expenditures aimed at acquiring or expanding cross-border corporate control over profit-generating assets. From an investor's perspective, FDI facilitates higher returns, while host countries benefit from capital inflows, technology transfer, employment creation, and skills development.

Consistent with findings from prior literature, this study posits that FDI positively and significantly contributes to economic growth by enhancing production capacities and promoting technological and human capital advancements in host economies.

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Trade Openness

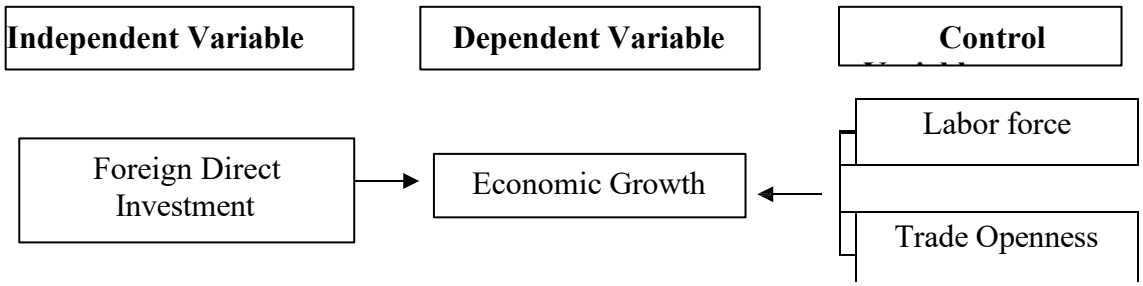
Trade openness reflects a country's degree of integration into the global economy through international trade. According to Fischer (2003), trade openness enhances economic efficiency by enabling countries to specialize based on comparative advantage, access larger markets, and import advanced technologies.

Openness to trade not only stimulates productivity but also attracts foreign investment by signaling favorable market conditions and reducing transaction costs associated with international business operations. This theoretical linkage underscores the importance of trade liberalization policies as complementary instruments for maximizing the growth-enhancing effects of FDI.

CONCEPTUAL FRAMEWORK AND RESEARCH HYPOTHESES

This study constructs a conceptual framework to explain the relationship between Foreign Direct Investment (FDI) as the independent variable and economic growth, measured by nominal GDP, as the dependent variable. It also includes trade openness and the labor force as control variables. Using annual data from Indonesia and Thailand spanning 1996–2023, the research employs the Vector Error Correction Model (VECM), Johansen cointegration test, and Granger causality test to assess long-term relationships among the variables. This framework integrates theory, empirical research, and conceptual reasoning to systematically guide the study's analysis. The conceptual framework will be used in this study is as follows:

Figure 2 Conceptual Framework



Source: Author's creation

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Global trade and international investment flows have become commonplace, with capital increasingly moving from developed to developing countries. This capital not only supports economic growth but also facilitates technological advancement in recipient countries (Romer, 1994). Based on previous empirical findings indicating that FDI generally exerts a positive and significant effect on economic growth, this study formulates the following hypotheses:

a) **Indonesia:**
   - *Ha0*: FDI has no significant impact on Indonesia's economic growth.
   - *Ha1*: FDI has a positive and significant impact on Indonesia's economic growth.

b) **Thailand:**
   - *Hb0*: FDI has no significant impact on Thailand's economic growth.
   - *Hb1*: FDI has a positive and significant impact on Thailand's economic growth.

These hypotheses reflect the expectation that FDI contributes positively to economic growth in the selected developing countries.

METHODOLODY

Econometric Approach and Variables

This study adopts a quantitative approach to analyze the relationship between Foreign Direct Investment (FDI) and economic growth in Indonesia and Thailand. The method involves Multiple Linear Regression to measure how changes in independent and control variables influence the dependent variable. The dependent variable is economic growth, represented by GDP growth; the independent variable is FDI, while trade openness and the labor force serve as control variables. Each country's data will be analyzed separately using the following regression equation:

$$GDP_{t-1} = \alpha + \beta 1 FDI_{t-1} + \beta 2 TOI_{t-1} + \beta 3 LF_{t-1} + \varepsilon_{t-1}$$

GDP_{t-1}	: GDP
α	: Constant Coefficient
FDI_{t-1}	: FDI
TO_{t-1}	: Trade Openness
LF_{t-1}	: Labor Force
β	: Regression Coefficient

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εt-1 : Error Term

Variables

The study uses one dependent, one independent, and two control variables:

Table 3: Table of Variable Definition

Independent Variable	
Foreign Direct Investment	Foreign direct investment inflows annually (Nominal in current USD)
Dependent Variables	
Economic Growth	GDP amount annually (Nominal in current USD)
Control Variables	
Trade Openness	Sums of exports and imports to GDP annually (Percentage Ratio)
Labor Force	Sums of employed and unemployed people in working-age annually (Nominal)

Source: Author's creation

Data

This research utilizes secondary data in nominal and ratio (percentage) form. Data are obtained from World Bank annual records for 1996–2023, chosen for their reliability and historical completeness.

Sample

A purposive sampling technique is applied, selecting Indonesia and Thailand based on specific research objectives and considerations, given these countries' relevance in examining FDI's influence on economic growth within the Southeast Asian context.

FINDING AND RESULTS

Unit Root Test Results

As an initial procedure prior to analyzing the relationship between the dependent and independent variables, a stationarity test must be conducted. In this research, the Augmented Dickey-Fuller (ADF) test is applied to determine whether the data series for each variable is stationary at the first difference level. The following tables present the

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outcomes of the ADF tests for each variable using data from the selected countries: Indonesia and Thailand.

Table 4: Augmented Dicky Fuller Test Statistic

Negara	Variabel	Level/Difference	ADF Test Statistic (P Value)
IDN	FDI	Level	0.5795
		Difference	**0.0001***
	GDP	Level	0.8975
		Difference	**0.0002***
	LF	Level	0.5975
		Difference	**0.0012***
	TO	Level	0.4780
		Difference	**0.0001***
THA	FDI	Level	0.0001
		Difference	**0.0001***
	GDP	Level	0.9378
		Difference	**0.0061***
	LF	Level	0.0926
		Difference	**0.0005***
	TO	Level	**0.0286***
		Difference	**0.0008***

*Denotes significant

Source: Author's calculation from Eviews13, 2025

Seen from the ADF test results in two countries above, it can be concluded that at a level not all variables stationary, but at the first differentiation, all variables are shows the stationarity.

Lag Length Selection

Before running a VECM and causality test, it is necessary to determine the optimal lag length in each country. The results for determining the length shows several options to choose from, namely: Sequential modified LR test statistics (LR), Final Prediction Error (FPE), Akaike Information Criteria (AIC), Schwarz Information Criteria (SC), and Hannan-

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Quinn Information Criterion (HQ). In this study, AIC will be used because, according to Liew (2004), it would be better to use AIC or FPE criteria for small sample sizes.

Table 5 Lag Length Selection (Indonesia)

Lag	LogL	LR	FPE	AIC	SC	HQ
0	474.252979	NA	4.86e+11	38.26024	38.45526	38.31433
1	-392.906315	130.1547*	2.66e+09*	33.03251	34.00761*	33.30296*
2	-380.967718	15.28140	4.13e+09	33.35742	35.11260	33.84423
3	-359.031651	21.05862	3.52e+09	32.88253*	35.41779	33.58571
* indicates lag order selected by the criterion Source: Author's calculation from Eviews13, 2025						

Table 6. Lag Length Selection (Thailand)

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-440.537134	NA	3.27e+10	35.56301	35.75803	35.61710
1	-362.147255	125.4246*	2.27e+08*	30.57178	31.54688*	30.84223*
2	-345.311298	21.55004	2.38e+08	30.50490*	32.26008	30.99172
3	-329.641113	15.04334	3.35e+08	30.53129	33.06655	31.23447
* indicates lag order selected by the criterion						
Source: Author's calculation from Eviews13, 2025						

The tables above show the optimal lag length selection in each country. The maximum lag to the AIC criteria in this study would use a maximum lag of 3 for Indonesia and lag of 2 for Thailand.

Cointegration Test Results

The condition in which not all variables in this study are stationary at their level values suggests the potential existence of a cointegration relationship among the variables. Since all variables become stationary after the first differencing, it is necessary to conduct the Johansen cointegration test to determine whether a long-term equilibrium relationship exists between them. This step is essential to avoid the risk of producing spurious regression results. If the Johansen cointegration test indicates the presence of cointegration, the Vector Error Correction Model (VECM) will be applied to analyze long-term relationships between the dependent and independent variables. Conversely, if no

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cointegration is detected, the study will proceed using the Vector Autoregression (VAR) method to examine the dynamic interactions among the variables.

Table 7: Johansen Cointegration Test Results (Indonesia)

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.795368	77.42298	47.85613	0.0000
At most 1 *	0.636342	39.34593	29.79707	0.0030
At most 2	0.436722	15.06896	15.49471	0.0579
At most 3	0.052465	1.293405	3.841465	0.2554

Trace test indicates 2 cointegrating eqn(s) at the 0.05 level

Source: Author's calculation from Eviews13, 2025

It can be seen in table 7 that in the Trace statistic test, a larger number is found than the critical value, as well as a p-value less than 5% at none and at most 1, which means the null hypothesis is rejected. The results of this test also showed that these variables indicated there was two cointegration.

Table 8: Johansen Cointegration Test Results (Thailand)

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0. 603707	61.96911	47.85613	0.0014
At most 1 *	0.571676	38.82906	29.79707	0.0035
At most 2 *	0.388929	17.63216	15.49471	0.0235
At most 3 *	0.191637	5.318595	3.841465	0.0211

Trace test indicates 4 cointegrating eqn(s) at the 0.05 level

Source: Author's calculation from Eviews13, 2025

A indication of 4 cointegration of the variables studied. It can be seen that the Trace statistics at none, most 1, most 2, and most 3 are greater than the critical value, as well as the p-value less than 5%, causing the null hypothesis to be rejected.

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With the results of the Johansen Cointegration test, which shows that there are cointegrations in these two sample countries, then determining whether there is long-term relationship between these variables will use the VECM analysis method.

Vector Error Correction Model Results

Since the Johansen Cointegration test before it was found that the variables to be used indicated have cointegration, then the VECM method would be used to analyze the relationship between the dependent and independent variables.

Table 9: Cointegrating Equations VECM Results in Long Run

Indonesia		**Thailand**	
Cointegrating Eq:	CointEq1	Cointegrating Eq:	CointEq1
GDP(-1)	1.000000	GDP(-1)	1.000000
FDI(-1)	-3.125078	FDI(-1)	-1.706907
	(1.757264)		(3.4135994)
	[-17.7838]*		**[-5.00031]***
TO(-1)	3.528256	TO(-1)	-7.2727073
	(0.793536)		(2.8047337)
	[4.44624]*		**[-2.59301]***
LF(-1)	2.859382	LF(-1)	9.9184645
	(0.332905)		(2.2573228)
	[8.58916]*		**[4.39391]***
C	-44.694267	C	24.309297

Standard errors in ( ) & t-statistics in [ ]
*Denotes significant at 5%
Source: Author's calculation from Eviews13, 2025

From the results above (table 6.6), the cointegration regression equation for the long- term relationship between Indonesia's variables can be formulated as follows:

$$gdpt\text{-}1 = 3.125078 fdit\text{-}1 - 3.528256 tot\text{-}1 - 2.859382 lft\text{-}1 + 44.694267$$

In the long run, the independent variable coefficient is read inversely based on the results listed in the equation, and then the regression results can be described as follows,

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in the long run, the FDI variable has a positive influence on the GDP variable, this shows that if the FDI variable rises one percent, then the GDP variable will increase 3.125078 percent, provided that the other free variables remain the same. Then both the TO and LF variables, in the long run, have a negative effect on GDP, this shows that when the TO and LF variables go up one percent, then it will decrease the GDP variable by 3.528256 percent and 2.859382 percent, respectively, with the condition that the other independent variables are constant.

The results of the cointegration regression equation of the variables in Thailand can be formulated as follows:

$$gdpt\text{-}1 = 1.706907fdit\text{-}1 + 7.2727073tot\text{-}1 - 9.9184645ft\text{-}1 - 24.309297$$

In the long run, it appears that the independent variable influences the dependent variable, the regression equation show the FDI variable has a positive relationship with the GDP variable, if the FDI variable increases one percent, it will increase the GDP variable by 1.706907 percent, with the condition that the other independent variables remain constant. For the TO variable shows positive effect on GDP where every increase in one percent variable TO causes a decrease in the GDP variable by 7.2727073 percent. The LF variable shows a negative relationship to the GDP variable, where when the LF variable rises one percent, the GDP variable has a decrease of 9.9184645 percent, all of this with the condition that the other independent variables remain at the same rate.

RESULTS

The findings of this study indicate that in the long run, FDI exerts a positive and substantial impact on economic growth in both Indonesia and Thailand, although the magnitude and direction of other variables differ across the two countries. In Indonesia, the long-run regression results suggest that a 1% increase in FDI is associated with a 3.125% increase in GDP, holding other variables constant. This supports the theoretical framework proposed by Solow (1956), which emphasizes capital accumulation as a driver of economic expansion, and aligns with Romer's (1990) endogenous growth theory that highlights the role of FDI in transferring technology and enhancing productivity. These findings are also consistent with prior empirical studies, such as Alzaidy et al. (2017) and Asafu-Adjaye (2000), which documented the positive influence of FDI on economic performance in developing economies.

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However, the impact of the control variables in Indonesia contrasts with theoretical expectations. In the long run, trade openness (TO) and labor force (LF) are both negatively associated with GDP. Specifically, a 1% increase in TO and LF is estimated to reduce GDP by 3.528% and 2.859%, respectively. These results may reflect structural weaknesses in Indonesia's trade composition and labor market, such as dependence on low-value exports and inefficiencies in labor absorption, which hinder the expected growth-enhancing effects of trade and employment expansion.

In Thailand, the long-run cointegration regression similarly reveals a positive relationship between FDI and GDP. A 1% increase in FDI leads to a 1.707% rise in GDP, suggesting that foreign capital inflows contribute meaningfully to the country's long-term economic performance. In contrast to Indonesia, trade openness in Thailand shows a strong positive relationship with GDP in the long run. This suggests that Thailand's engagement in international trade has contributed positively to its economic growth. The result aligns with the view that greater openness can enhance market access, stimulate competition, and encourage efficiency. However, the extent of this impact may still be influenced by the sectoral distribution of trade and the country's exposure to external economic conditions, which could affect how evenly the benefits of trade are realized across the broader economy. Likewise, the labor force variable in Thailand exhibits a large negative long-run effect, with a 1% increase in LF associated with a 9.918% decline in GDP. This may point to inefficiencies in labor market utilization or mismatches between labor supply and demand across sectors.

Overall, while FDI remains a key driver of long-run economic growth in both Indonesia and Thailand, the effects of trade openness and labor force variables underscore the importance of complementary policies to enhance the quality of trade and labor market outcomes, ensuring that structural factors do not offset the benefits of foreign investment.

CONCLUSION

This study investigates the long-run impact of Foreign Direct Investment (FDI) on economic growth in Indonesia and Thailand over the period 1996–2023, using the Vector Error Correction Model (VECM), with trade openness and labor force included as control variables. The findings confirm that FDI plays a significant and positive role in supporting long-term economic growth in both countries, in line with endogenous growth theory, which emphasizes capital accumulation, technology transfer, and productivity spillovers from foreign investors.

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In Indonesia, the results indicate that FDI has contributed substantially to economic expansion over the long run. However, trade openness and labor force exert a negative and significant influence on GDP. These findings may reflect structural inefficiencies in Indonesia's trade composition—such as a reliance on low-value-added exports—and challenges within the labor market, including limited employment absorption and productivity gaps.

Thailand also demonstrates a positive long-run relationship between FDI and GDP, though with a smaller effect compared to Indonesia. Notably, trade openness in Thailand shows a strong positive impact on economic growth, suggesting that the country's integration into international markets has enhanced competitiveness and efficiency. Nevertheless, the labor force variable in Thailand exhibits a negative long-run effect, potentially indicating mismatches between labor supply and demand or inefficiencies in workforce utilization.

Overall, while FDI continues to be a critical driver of economic growth in both countries, the contrasting effects of trade openness and labor force variables underscore the importance of structural reforms. Enhancing trade quality, improving labor market efficiency, and ensuring inclusive sectoral distribution of investment are essential to maximize the long-term benefits of FDI. Future research is encouraged to incorporate additional variables such as institutional quality, productivity, and capital market development to gain a more comprehensive understanding of growth dynamics in emerging economies.

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