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RESEARCH ARTICLE

# Macroeconomic and Political Determinants of Foreign Direct Investment in Indonesia: An Error Correction Model Aproach

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**Abstract**
This study examines the effects of Gross Domestic Product (GDP), inflation, interest rates, and political stability on Foreign Direct Investment (FDI) in Indonesia over the period 2003 to 2024. The study employs the Error Correction Model (ECM) to distinguish between short-run and long-run relationships. The results indicate that inflation has a positive and significant effect on FDI in the short run, while political stability has a positive and significant effect on FDI in the long run. Meanwhile, GDP and interest rates do not show a statistically significant effect. These findings suggest that political stability and inflation control should be key priorities in efforts to attract foreign investment.

**Keywords**
Economic Growth; Inflation; Interest Rates; Political Stability; Foreign Direct Investment (FDI).

# 1 | INTRODUCTION

Indonesia, as one of the largest economies in Southeast Asia, still faces limitations in providing sufficient domestic investment financing due to the gap between domestic savings and investment needs (Beck, 2016). Although various policies have been implemented to increase savings, the level of domestic savings remains insufficient to finance development requirements, particularly in infrastructure and strategic sectors (Purwono & Hayati, 2021). According to Statistics Indonesia (BPS, 2025), domestic savings growth has not kept pace with increasing investment demand, resulting in a persistent saving–investment gap. This gap has important implications for economic development because insufficient domestic savings limit the availability of funds for investment and reduce a country's capacity to sustain long-term economic growth. In many developing economies, the saving-investment gap remains a major challenge that necessitates reliance on external sources of financing, including foreign direct investment and external borrowing (Amril, 2013; Asrini *et al*., 2023; Todaro & Smith, 2020). One of the consequences of this financing constraint is inadequate infrastructure development, which may reduce productivity and economic efficiency. In Indonesia, infrastructure limitations have contributed to high logistics costs and weakened business competitiveness (Ali & Mingque, 2018). To overcome this financing constraint, Indonesia increasingly relies on external capital sources, including foreign direct investment (FDI), external debt, and other international financing mechanisms (Asrini *et al*., 2023). Among these, FDI is generally regarded as a more sustainable source of external financing because it does not generate debt repayment obligations and can promote long-term economic development through capital accumulation, technology transfer, productivity improvements, and institutional development (Fitri Wilujeng, 2021; Jacob *et al*., 2024; Kharisma *et al*., 2025). FDI inflows are influenced by both macroeconomic and institutional conditions. Macroeconomic factors such as economic growth, inflation, and interest rates affect expected returns and investment costs, while political stability reduces uncertainty and investment risk. A stable economic and political environment can therefore enhance investor confidence and increase a country's attractiveness as an investment destination (Ali & Mingque, 2018; Fatimah, 2021).

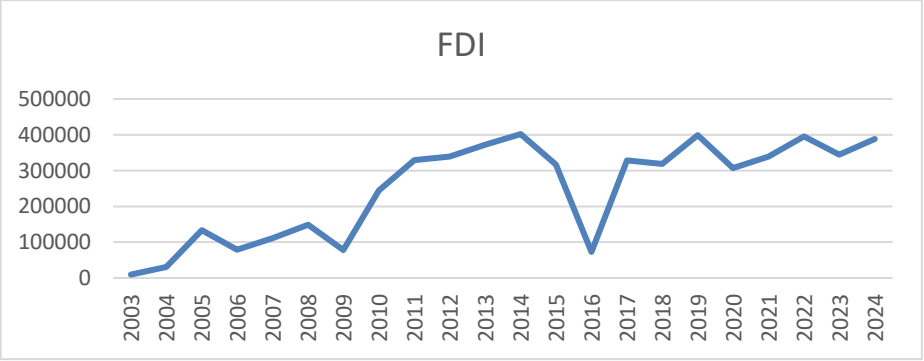


Figure 1. Trends in Foreign Direct Investment (FDI) in Indonesia (2003-2024)

Figure 1 presents the trend of Foreign Direct Investment (FDI) inflows in Indonesia during 2003–2024. The figure shows that FDI fluctuated significantly over the period, with a notable increase during 2010–2014, driven by improved macroeconomic conditions and stronger investor confidence. However, a decline occurred in 2009 due to the global financial crisis, followed by a gradual recovery in subsequent years.

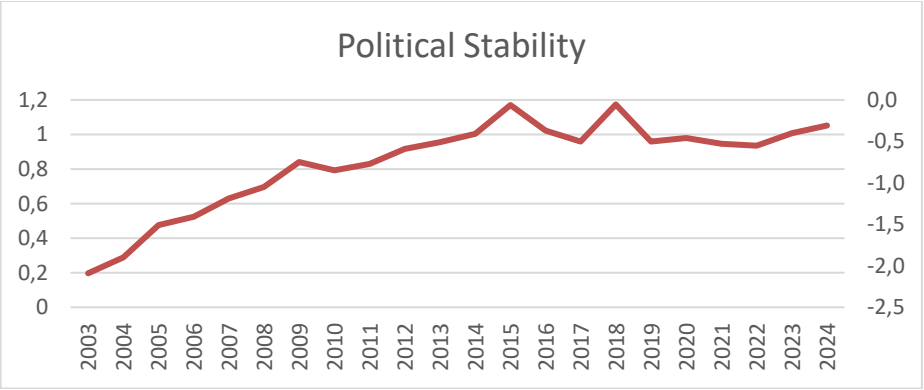


Figure 2. Political Stability Index in Indonesia (2003–2024)

Political stability is also a crucial determinant of investment decisions because it reflects policy certainty and risk conditions faced by investors. Figure 2 illustrates the Political Stability Index in Indonesia during 2003–2024. The index shows fluctuations over time, indicating changes in governance conditions and political dynamics. Although Indonesia has generally maintained relatively stable conditions, periods of uncertainty remain relevant for foreign investment decisions. Previous studies confirm that both macroeconomic and institutional factors influence FDI inflows. Arsad *et al*. (2022) found that economic growth, inflation, and interest rates significantly affect FDI, while Fatimah (2021) emphasized the importance of political stability and economic growth. Recent studies also highlight that institutional quality and political stability play an increasingly important role in reducing uncertainty and strengthening investor confidence (Le *et al*., 2023; Kurniawan *et al*., 2025; Vu, 2025). However, most previous studies analyze macroeconomic and institutional determinants separately or use cross-country panel data approaches. Evidence on the simultaneous short-run and long-run effects of economic growth, inflation, interest rates, and political stability in Indonesia using a single time-series framework remains limited. Therefore, this study aims to analyze the short-run and long-run effects of economic growth, inflation, interest rates, and political stability on FDI inflows in Indonesia during 2003–2024 using the Error Correction Model (ECM). This study contributes by integrating macroeconomic and institutional factors within a unified framework and provides policy-relevant insights for improving Indonesia's investment climate.

## 2 | BACKGROUND THEORY

### 2.1 Economic Growth and Foreign Direct Investment

Economic growth reflects the expansion of economic activities and market opportunities within a country. According to the Harrod-Domar theory, economic growth depends on capital accumulation and investment, while the market-seeking motive of FDI suggests that multinational enterprises tend to invest in countries with strong economic performance because expanding markets increase the potential return on investment. Countries experiencing higher economic growth generally offer larger markets, greater profit opportunities, and a more favorable business environment, thereby attracting foreign investors. Previous studies have shown that economic growth positively influences FDI inflows by increasing business opportunities and investor confidence (Febriana & Muqorobbin, 2014; Mainita & Soleh, 2019). Therefore, higher economic growth is expected to encourage FDI inflows. H1: Economic growth significantly affects foreign direct investment.

### 2.2 Inflation and Foreign Direct Investment

Inflation is an important indicator of macroeconomic stability and may influence foreign investment decisions through its impact on production costs, purchasing power, and economic uncertainty. According to Keynesian investment theory, high inflation can reduce investment incentives by increasing uncertainty and production costs, thereby lowering expected returns on investment (Keynes, 1936). Conversely, stable inflation may signal a healthy economic environment that supports business activities and investment. Empirical studies have found that inflation significantly affects foreign direct investment inflows (Arsad *et al*., 2022; Mustofa, 2024). Therefore, inflation is expected to influence foreign direct investment. H2: Inflation significantly affects foreign direct investment.

### 2.3 Interest Rates and Foreign Direct Investment

Interest rates represent the cost of capital and influence investment decisions. According to Keynes' Liquidity Preference Theory, higher interest rates increase borrowing costs and may reduce the attractiveness of investment projects, while lower interest rates can stimulate investment by lowering financing costs and improving expected returns. For foreign investors, interest rates also serve as an indicator of a country's monetary conditions and investment climate. Empirical evidence indicates that interest rates are an important determinant of FDI inflows (Keynes, 1936; Arsad *et al*., 2022). Therefore, interest rates are expected to influence foreign direct investment. H3: Interest rates significantly affect foreign direct investment.

### 2.4 Political Stability and Foreign Direct Investment

Political stability creates a predictable environment that supports investment activities. According to Political Risk Theory, political stability reduces uncertainty regarding government policies, property rights protection, and business continuity, thereby encouraging foreign investment (Busse & Hefeker, 2007). In addition, Dunning's Eclectic Paradigm (OLI) suggests that location-specific advantages, including political stability and institutional quality, influence multinational enterprises' investment decisions (Dunning, 1988). A stable political environment improves policy predictability, strengthens investor confidence, and reduces investment risk, making countries more attractive to foreign investors. Previous studies have shown that political stability positively affects FDI inflows (Fatimah, 2021; Busse & Hefeker, 2007). Countries with more stable political environments are expected to attract higher levels of foreign direct investment. H4: Political stability significantly affects foreign direct investment.

# 3 | METHOD

## 3.1 Data and Variables

This study employs annual time-series data covering the period 2003–2024. The period was selected because it captures major economic and political developments in Indonesia, including post-reform economic recovery, changes in monetary policy, political transitions, and recent economic disruptions. Data were obtained from Statistics Indonesia (BPS), Bank Indonesia (BI), the World Bank, and the Worldwide Governance Indicators (WGI).

Table 1. Operational Definitions and Measurement of Variables

| Variable | Definition | Unit | Source |
|---|---|---|---|
| FDI | Foreign Direct Investment Inflows | Million US$ | World Bank |
| GDP | Economic Growth Rate | Billion Rupiah | BPS |
| INF | Inflation Rate | Percent (%) | BPS |
| IR | BI Rate | Percent (%) | Bank Indonesia |
| PS | Political Stability Index | Index (-2.5 to 2.5) | Worldwide Governance Indicator (WGI) |

All variables were analyzed in their original form. GDP is measured in billion rupiah at constant prices, FDI in million US dollars, inflation and interest rates in percentage terms, and political stability in index values.

## 3.2 Model Specification

The long-run relationship among the variables is specified as follows:

$$FDI_t = \beta_0 + \beta_1 GDP_t + \beta_2 INF_t + \beta_3 IR_t + \beta_4 PS_t + \varepsilon_t$$

Where:
$FDI_t$ = Foreign Direct Investment inflows in year t (million US dollars);
$GDP_t$ = Gross Domestic Product at constant prices in year t (billion rupiah);
$INF_t$ = Inflation rate in year t (percent);
$IR_t$ = Interest rate (BI Rate) in year t (percent);
$PS_t$ = Political Stability and Absence of Violence/Terrorism Index in year t;
$\beta_0$ = Constant term;
$\beta_1 - \beta_4$ = Long-run coefficients of the independent variables;
$\varepsilon_t$ = Error term;
t = Time period (2003–2024).

## 3.3 Estimation Procedure

The Error Correction Model (ECM) approach was employed to estimate both the short-run and long-run relationships among foreign direct investment, economic growth, inflation, interest rates, and political stability. The estimation procedure consisted of three stages. First, stationarity was examined using the Augmented Dickey-Fuller (ADF) unit root test. Variables were considered stationary when their probability values were lower than the selected significance level. The optimal lag length was determined based on the Akaike Information Criterion (AIC). Second, cointegration was tested using the Engle-Granger approach by examining the stationarity of the residuals obtained from the long-run equation. Finally, after cointegration was confirmed, the short-run dynamics were estimated using the Error Correction Model (ECM). The ECM specification is expressed as follows:

$$\Delta FDI_t = \alpha_0 + \alpha_1 \Delta GDP_t + \alpha_2 \Delta INF_t + \alpha_4 \Delta IR_t + \alpha_5 \Delta PS_t + \lambda ECT_{t-1} + \mu_t$$

Where Δ denotes the first-difference operator, ECTt−1 represents the error correction term lagged one period, λ measures the speed of adjustment toward long-run equilibrium, and μt is the disturbance term. This study adopts a 10 percent significance level because the sample size is relatively small for time-series analysis. The use of a 10 percent significance level is common in empirical studies with limited observations and helps identify potentially meaningful relationships that may not be detected under more restrictive significance levels.

# 4 | RESULTS AND DISCUSSION

## 4.1 Results

Table 2. Stationarity Test Result

| ADF Stat | Level | | 1st Difference | |
|---|---|---|---|---|
| | T-stat | Prob | T-stat | Prob |
| FDI | -2.225470 | 0.2040 | -5.756151 | 0.0002 |
| GDP | 0.402775 | 0.9766 | -4.304187 | 0.0044 |
| Inflation | -1.423579 | 0.5499 | -6.287501 | 0.0001 |
| Interest Rate | -2.093713 | 0.2688 | -6.188488 | 0.0001 |
| Political Stability | -2.752348 | 0.0831 | -5.298113 | 0.0005 |

The stationarity test was conducted using the Augmented Dickey-Fuller (ADF) test to determine whether the variables contain a unit root and to ensure that the data satisfy the requirements for Error Correction Model (ECM) estimation. Stationary variables are essential in time-series analysis because non-stationary data may lead to spurious regression results and unreliable statistical inferences. The results presented in Table 1 indicate that, at the level form, Foreign Direct Investment (FDI), Gross Domestic Product (GDP), inflation, and interest rates are non-stationary, as evidenced by probability values greater than the 10 percent significance level. Meanwhile, the political stability variable is stationary at the level form, with a probability value of 0.0831, which is lower than the selected significance level. To achieve stationarity, all variables were transformed into their first differences. The results show that all variables become stationary after first differencing, with probability values below the 10 percent significance level. These findings indicate that all variables are integrated of order one, I(1), and therefore satisfy the prerequisite for cointegration testing. Consequently, the variables can be further analyzed using the ECM framework to investigate both short-run and long-run relationships among the variables.

Table 3. Cointegration Test Result

| | | t-statistic | Prob.* |
|---|---|---|---|
| Augmented Dickey-Fuller test statistic | | -3.72185 | 0.0120 |
| Test critical values: | 1% level | -3.808546 | |
| | 5% level | -3.020686 | |
| | 10% level | -2.650413 | |

The cointegration test was performed using the Engle-Granger approach to determine whether a long-run equilibrium relationship exists among the variables included in the model. Cointegration is an important prerequisite for the application of the ECM because it indicates that non-stationary variables move together over time and maintain a stable long-run relationship. As reported in Table 2, the Augmented Dickey-Fuller statistic of the residual series is -3.721850 with a probability value of 0.0120. Since the probability value is lower than the 10 percent significance level, the null hypothesis of no cointegration is rejected. This finding confirms the existence of a long-run equilibrium relationship among Foreign Direct Investment (FDI), Gross Domestic Product (GDP), inflation, interest rates, and political stability. The presence of cointegration suggests that although short-run fluctuations may occur due to economic or political shocks, the variables tend to converge toward a common equilibrium path over time. Therefore, the ECM approach is appropriate because it enables the estimation of both short-run dynamics and long-run equilibrium relationships simultaneously.

Table 4. Short-Run Regression Results

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| D (GDP) | 3.092437 | 6.209564 | 0.498012 | 0.6262 |
| D (Inflation) | 16228.96 | 6816.749 | 2.380848 | 0.0320 |
| D (Interest Rate) | 9719.690 | 12605.44 | 0.771071 | 0.4422 |
| D (Political Stability) | 86588.77 | 90025.02 | 0.961830 | 0.3527 |
| ECT(-1) | -0.883704 | 0.247168 | -3.575310 | 0.0033 |
| C | 9675.081 | 197741.53 | 0.490088 | 0.6309 |
| R-squared | 0.572896 | Mean dependent var | | 16755.20 |
| Adjusted R-squared | 0.420358 | S.D dependent var | | 104326.0 |
| S.E of regression | 79427.79 | Akaike info criterion | | 25.64641 |
| Sum squared resid | 8.83E+10 | Schwarz criterion | | 25.94513 |
| Log likelihood | -250.4641 | Hannan-Quinn criter | | 25.70472 |

| | | | |
|---|---|---|---|
| F-statistic | 3.755775 | Durbin-Watson stat | 2.025654 |
| Prob (F-statistic) | 0.022927 | | |

The short-run dynamics of Foreign Direct Investment (FDI) were estimated using the Error Correction Model (ECM), and the results are presented in Table 3. The findings indicate that inflation has a positive and statistically significant effect on FDI at the 10 percent significance level, while GDP, interest rates, and political stability do not exhibit statistically significant effects in the short run. The positive coefficient of inflation suggests that moderate increases in prices may reflect stronger domestic demand and improved economic activity, thereby creating favorable market conditions for foreign investors. This finding indicates that inflation, when maintained within a manageable range, is not necessarily perceived as a source of macroeconomic instability by foreign investors. Furthermore, the Error Correction Term (ECT) coefficient is negative and statistically significant, with a value of -0.883704. This result confirms the existence of a stable long-run equilibrium relationship among the variables. The coefficient implies that approximately 88.37 percent of short-run disequilibrium is corrected within one year, indicating a relatively rapid adjustment process toward long-run equilibrium.

Table 5. Long-Run Regression Results

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| GDP | 7.491561 | 8.918178 | 0.840033 | 0.4067 |
| Inflation | 6508.811 | 11170.29 | 0.56372 | 0.5807 |
| Interest Rate | -10942.27 | 18182.17 | -0.581079 | 0.5693 |
| Political Stability | 124841.0 | 62443.15 | 1.999274 | 0.0629 |
| C | 321179.6 | 167248.5 | 1.906590 | 0.0747 |
| R-squred | 0.613582 | Mean dependent var | | 15199.81 |
| Adjusted R-squared | 0.516978 | S.D dependent var | | 8517.459 |
| S.E of regression | 5919.618 | Akaike info criterion | | 20.41419 |
| Sum squared resid | 5.61E+08 | Schwarz criterion | | 20.66288 |
| Log likelihood | -209.3490 | Hannan-Quinn criter | | 20.46816 |
| F-statistic | 6.351488 | Durbin-Watson stat | | 1.734457 |
| Prob (F-statistic) | 0.002937 | | | |

The long-run estimation results presented in Table 4 reveal that political stability is the only variable that has a positive and statistically significant effect on Foreign Direct Investment (FDI). Meanwhile, GDP, inflation, and interest rates do not exhibit statistically significant effects in the long run. The positive coefficient of political stability indicates that improvements in political conditions contribute to higher inflows of foreign investment. This finding suggests that foreign investors place considerable importance on policy consistency, institutional quality, legal certainty, and political security when making long-term investment decisions. The insignificance of GDP, inflation, and interest rates implies that macroeconomic indicators alone are insufficient to explain long-run FDI inflows in Indonesia. Instead, institutional and political factors appear to play a more decisive role in shaping foreign investors' long-term investment decisions.

### 4.1.1 Coefficient of Determination Test

The coefficient of determination ($R^2$) measures the ability of the independent variables to explain variations in Foreign Direct Investment (FDI). The long-run estimation produces an $R^2$ value of 0.613582, indicating that approximately 61.35 percent of the variation in FDI can be explained by GDP, inflation, interest rates, and political stability. The remaining 38.65 percent is influenced by other factors not included in the model. Meanwhile, the short-run model generates an $R^2$ value of 0.572896, suggesting that 57.29 percent of the variation in FDI is explained by the explanatory variables included in the ECM model. This result indicates that the selected variables provide a relatively good explanation of FDI movements in Indonesia, both in the short run and the long run.

### 4.1.2 F-Test

The F-test was conducted to examine the joint significance of the independent variables in explaining Foreign Direct Investment (FDI). Based on the estimation results, the probability value of the F-statistic is 0.022927 for the short-run model and 0.002937 for the long-run model. Since both probability values are lower than the 10 percent significance level, the null hypothesis is rejected. This finding indicates that GDP, inflation, interest rates, and political stability collectively have a statistically significant effect on FDI in Indonesia. Therefore, the explanatory variables included in the model jointly contribute to explaining variations in foreign investment inflows.

### 4.1.3 T-Test

The t-test was employed to assess the individual effect of each explanatory variable on Foreign Direct Investment (FDI). The long-run estimation results reveal that political stability is the only variable that significantly affects FDI, as indicated by its probability value of 0.0629, which is below the 10 percent significance level. In contrast, GDP, inflation, and interest rates have probability values exceeding the significance threshold, indicating that their effects are statistically insignificant. For the short-run model, inflation is the only variable that exhibits a statistically significant effect on FDI, with a probability value of 0.0320. Meanwhile, GDP, interest rates, and political stability remain statistically insignificant. These findings suggest that inflation plays a more important role in influencing short-run investment decisions, whereas political stability becomes more relevant in shaping long-run foreign investment inflows.

Table 6. Autocorrelation Test Result

| | | | |
|---|---|---|---|
| F-statistic | 0.202012 | Prob. F(2.14) | 0.8194 |
| Obs*R-squared | 0.589036 | Prob. Chi-Square (2) | 0.7449 |

The autocorrelation test was performed to determine whether the residuals are correlated across time periods. Autocorrelation may lead to inefficient parameter estimates and unreliable statistical inference if present in the model. The results reported in Table 5 show that the Prob. Chi-Square value is 0.7449, which is greater than the 10 percent significance level. Therefore, the null hypothesis of no autocorrelation cannot be rejected. This finding indicates that the residuals are independently distributed and that the model does not suffer from autocorrelation problems.

Table 7. Multicollinearity Test Result

| Variable | Coefficient Variance | Uncentered VIF | Centered VIF |
|---|---|---|---|
| GDP | 79.53391 | 15.45477 | 3.399233 |
| Inflation | 1.25E+08 | 11.06186 | 2.285982 |
| Interest Rate | 3.31E+08 | 41.82335 | 4.003864 |
| Political Stability | 3.90E+09 | 8.300360 | 2.672191 |
| C | 2.80E+10 | 65.75249 | NA |

The multicollinearity test was conducted to examine whether strong correlations exist among the independent variables included in the model. High multicollinearity can distort coefficient estimates and reduce the reliability of the regression results. Based on the results presented in Table 6, the centered Variance Inflation Factor (VIF) values for GDP, inflation, interest rates, and political stability are all below the commonly accepted threshold value of 10. This indicates that there is no serious multicollinearity problem among the explanatory variables. Therefore, it can be concluded that each independent variable provides distinct information in explaining Foreign Direct Investment (FDI), and the estimated coefficients can be interpreted reliably without concerns regarding excessive correlation among the regressors.

## 4.2 Discussion

The estimation results indicate that Gross Domestic Product (GDP) has a positive but statistically insignificant effect on Foreign Direct Investment (FDI) in Indonesia in both the short run and the long run. Theoretically, this relationship can be explained by the Market Size Hypothesis within Dunning's OLI Paradigm (Dunning, 1988), which suggests that larger market size should increase a country's attractiveness to foreign investors by providing greater opportunities for profit generation. However, the findings imply that economic growth alone is insufficient to serve as a primary determinant of FDI inflows into Indonesia. This result suggests that foreign investors do not solely rely on output growth when making investment decisions. Instead, they tend to consider a broader set of factors, including institutional quality, regulatory certainty, infrastructure availability, bureaucratic efficiency, and the overall investment climate. Consequently, sustained economic growth may not automatically translate into higher FDI inflows if it is not accompanied by improvements in the business environment and governance quality. The findings are consistent with previous studies by Anindita *et al*. (2021), Sumiyati (2021), Sijabat (2023), Maharani and Setyowati (2024), and Yuliani *et al*. (2024), which report that economic growth is not always a significant determinant of FDI. Similarly, OECD (2023) emphasizes that institutional quality, policy certainty, and investment facilitation measures have become increasingly important considerations for multinational enterprises when selecting investment locations. ASEAN Secretariat (2024) also highlights that ASEAN countries are increasingly competing for foreign investment through institutional reforms and improvements in the ease of doing business rather than relying solely on economic growth performance. Nevertheless, this finding contrasts with the studies of Kharisma *et al*. (2025) and Alshammari *et al*. (2024), which demonstrate that economic growth can positively influence FDI when supported by strong institutional frameworks and favorable socio-economic conditions. These differences may be attributed to variations in research periods, country characteristics, and the relative importance of institutional factors across economies.

In the Indonesian context, various investment reforms have been implemented in recent years, including the Online Single Submission (OSS) system, simplification of business licensing procedures, and improvements in public service delivery. These reforms indicate that structural and institutional factors may play a more substantial role than economic growth itself in attracting foreign investment. Therefore, efforts to strengthen institutional quality, enhance regulatory effectiveness, and maintain policy consistency are essential to complement economic growth and improve Indonesia's attractiveness as a destination for foreign direct investment. The results indicate that inflation has a positive and significant effect on Foreign Direct Investment (FDI) in the short run but becomes statistically insignificant in the long run. From a theoretical perspective, this relationship can be explained by Keynesian Investment Theory, which suggests that inflation influences investment decisions through its impact on cost expectations, aggregate demand, and economic uncertainty. Moderate inflation may signal rising economic activity and stronger domestic demand, thereby creating favorable market opportunities for foreign investors. The positive short-run effect suggests that inflation in Indonesia may reflect expanding economic activity rather than macroeconomic instability. In developing economies, moderate inflation often accompanies increasing consumption, business expansion, and improvements in market prospects. Consequently, foreign investors may perceive moderate inflation as an indicator of growing demand and potential profitability in the short term.

However, the insignificant long-run effect implies that foreign investors tend to prioritize overall macroeconomic stability rather than temporary price fluctuations when making investment decisions. Long-term investments generally involve substantial capital commitments and therefore require a stable and predictable economic environment. As a result, investors are more likely to evaluate broader economic fundamentals, including institutional quality, policy consistency, and long-term growth prospects, rather than focusing solely on inflation dynamics. This finding is consistent with the studies of Sumiyati (2021), Chandra and Handoyo (2020), Arsad *et al*. (2022), Maharani and Setyowati (2024), Maulidiyah and Fuddin (2024), Yuliani *et al*. (2024), and Ulan Dari and Astuti (2025), which suggest that the influence of inflation on FDI may differ across time horizons and economic conditions. Similarly, UNCTAD (2024) emphasizes that macroeconomic stability remains a key determinant of investment attractiveness in developing countries. Azizah *et al*. (2025) further argue that economic stability plays an important role in shaping investors' perceptions of investment risk within ASEAN economies. In the Indonesian context, the inflation-targeting framework implemented by Bank Indonesia has contributed to maintaining inflation within a relatively stable range over the years. This achievement has helped reduce uncertainty associated with price volatility and strengthen investor confidence in the Indonesian economy. Therefore, although inflation may influence FDI in the short run, maintaining long-term macroeconomic stability remains essential for sustaining foreign investment inflows and enhancing Indonesia's attractiveness as an investment destination. The estimation results indicate that interest rates do not have a statistically significant effect on Foreign Direct Investment (FDI) in either the short run or the long run. From a theoretical perspective, Liquidity Preference Theory (Keynes, 1936) suggests that interest rates influence investment decisions through their effect on the cost of capital. However, in the context of FDI, the relevance of domestic interest rates appears to be limited because foreign direct investment generally involves long-term strategic commitments rather than short-term financial considerations.

The insignificant relationship suggests that foreign investors do not regard domestic interest rates as a primary determinant when selecting investment destinations in Indonesia. Unlike portfolio investors, who are typically more responsive to interest rate fluctuations, foreign direct investors tend to focus on long-term profitability, market potential, resource availability, institutional quality, and the overall business environment. Consequently, changes in domestic borrowing costs may have only a limited impact on FDI decisions. One possible explanation is that multinational corporations often obtain financing from international capital markets or their home countries, reducing their dependence on domestic financial conditions. As a result, fluctuations in Indonesia's interest rates may not significantly alter their investment plans or capital allocation decisions. Instead, investors are more likely to evaluate factors such as regulatory certainty, governance quality, infrastructure development, and policy consistency when making long-term investment decisions. This finding is consistent with the studies of Chandra and Handoyo (2020), Sumiyati (2021), Sijabat (2023), Maharani and Setyowati (2024), Yuliani *et al*. (2024), and Kurniawan *et al*. (2025), which suggest that interest rates are not among the most influential determinants of FDI in developing economies. Similarly, OECD (2023) and UNCTAD (2024) emphasize that investment decisions are increasingly shaped by institutional quality, investment facilitation policies, and regulatory effectiveness rather than by borrowing costs alone. In the Indonesian context, recent efforts to improve infrastructure, simplify business regulations, strengthen legal certainty, and enhance the ease of doing business may play a more important role in attracting foreign investment than monetary policy variables. Therefore, while interest rate management remains essential for maintaining macroeconomic stability, policies aimed at improving institutional quality and creating a more conducive investment climate are likely to be more effective in increasing FDI inflows over the long term. The results indicate that political stability has a positive and significant effect on Foreign Direct Investment (FDI) in the long run, while its effect is insignificant in the short run. This finding suggests that political stability is a crucial determinant of foreign investment decisions in Indonesia, particularly for investments involving long-term commitments. From a theoretical perspective, the result supports Political Risk Theory, which argues that stable political conditions reduce uncertainty, lower investment risk, and enhance investor confidence.

It also aligns with Dunning's OLI Paradigm, specifically the location advantage component, which identifies political stability as an important factor influencing a country's attractiveness to foreign investors. The positive long-run relationship indicates that foreign investors place considerable importance on the predictability and continuity of government policies, legal certainty, property rights protection, and the effectiveness of public institutions. Political stability creates a favorable business environment by reducing the likelihood of policy reversals, political unrest, and institutional disruptions that may negatively affect investment performance. Consequently, countries with more stable political environments are generally perceived as more attractive destinations for foreign capital. In contrast, the insignificant short-run effect suggests that temporary political fluctuations do not immediately influence FDI inflows. Foreign direct investment decisions typically involve extensive planning processes, feasibility studies, and long-term strategic considerations. Therefore, investors tend to respond more to sustained political conditions than to short-term political events or uncertainties. This finding is consistent with the studies of Fatimah (2021), Faruq (2023), Le *et al*. (2023), Maulidiyah and Fuddin (2024), Azizah *et al*. (2025), Vu (2025), Kurniawan *et al*. (2025), Shah and John (2025), and Rastiati and Khoirudin (2025), which conclude that political stability is among the most influential determinants of FDI in developing and emerging economies. These studies emphasize that foreign investors generally prefer countries characterized by predictable policies, effective governance, strong legal institutions, and low levels of political uncertainty. Likewise, World Bank (2024) highlights that governance quality and political stability are closely associated with investment attractiveness, while IMF (2023) notes that political uncertainty can increase perceived risks and discourage long-term investment commitments. In the Indonesian context, democratic consolidation, improvements in governance quality, regulatory reforms, and efforts to strengthen legal certainty have contributed to a more conducive investment climate. Initiatives aimed at simplifying investment regulations, enhancing bureaucratic efficiency, and improving public service delivery have reduced political risk perceptions and strengthened investor confidence. Therefore, maintaining political stability, improving institutional quality, and ensuring policy consistency should remain key priorities for sustaining and increasing FDI inflows in Indonesia over the long term.

## 5 | CONCLUSIONS AND FUTURE WORK

The findings of this study lead to the following conclusions: (1) Gross Domestic Product (GDP) has a positive but insignificant effect on Foreign Direct Investment (FDI) in both the long run and the short run. (2) In the long run, inflation has a positive but insignificant effect on FDI, whereas in the short run, inflation exerts a positive and significant effect on FDI in Indonesia. (3) Interest rates exhibit a negative but insignificant effect on Foreign Direct Investment in the long run, while in the short run, interest rates show a positive but insignificant effect on FDI in Indonesia. (4) Political stability has a positive and significant effect on FDI in the long run, whereas in the short run, political stability does not have a significant effect on Foreign Direct Investment in Indonesia. Considering the limitations of this study, future researchers are encouraged to incorporate additional variables such as exchange rates, trade openness, infrastructure quality, labor costs, institutional quality, and sectoral composition of FDI. In addition, further studies may employ alternative econometric approaches such as the Autoregressive Distributed Lag (ARDL) model or Vector Error Correction Model (VECM), particularly when stationarity tests indicate different orders of integration across variables. From a policy perspective, the implications of this study should be primarily directed toward the variables that are statistically significant. Since political stability is significant in the long run, policymakers should prioritize ensuring regulatory certainty, policy consistency, strengthening investor protection, and reducing political risk to attract sustained foreign investment. Meanwhile, because inflation is significant in the short run, maintaining price stability through effective monetary policy is essential to stabilize investor expectations and support investment inflows.

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