CHAPTER III

CONCEPTUAL FRAMEWORK

1.1. Conceptual Framework

According to Harrod-Domar and Robert Solow theory on previous chapter, to accelerate economic growth it needs extra capital which sources from investment and saving on that country, where the investment comes from another country or foreign direct investment. Furthermore, foreign direct investment could be affected by country's governance quality and tax incentives facility from government, such as tax holiday. Therefore, this research is analyze the effect of governance quality and tax holiday on foreign direct investment and economic growth.

Moreover, the country's governance quality also have effect on FDI inflow. According to Saidi et al (2013) on the study about impact of governance indicators on FDI, there are only two indicators of governance having a significant impact on FDI inflows, namely, political stability and regulatory quality. Furthermore, this research is employ six governance indicator from World Bank (2015) as an independent variable, namely: Voice and Accountability, Political Stability and Absence of Violence/Terrorism, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption. In addition, tax holiday which is offered by government from 2011 also act as independent variable for FDI.

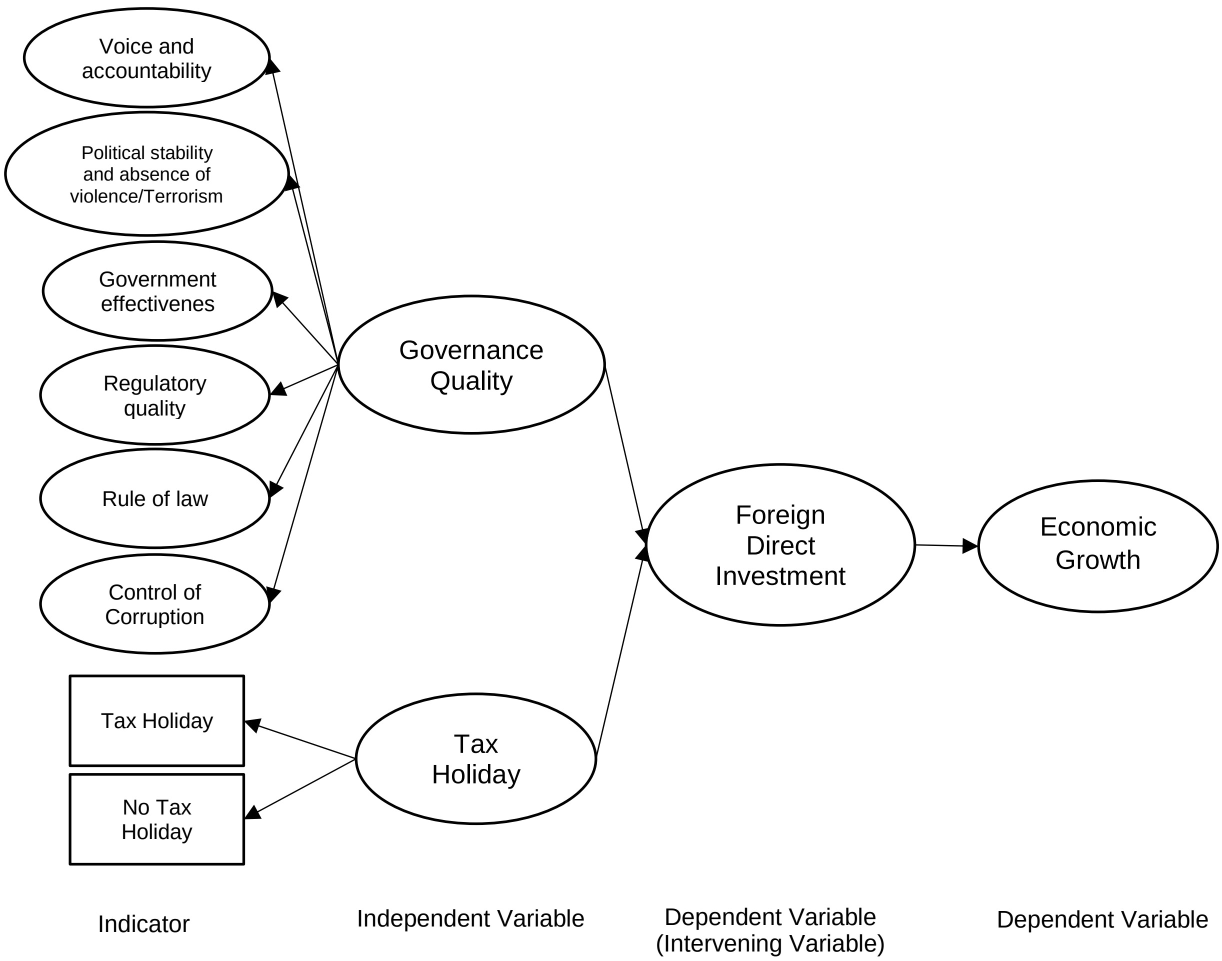
On Robert Solow theory or neo-classical growth theory in Todaro (2012), economic growth is a result from three important components, capital accumulation, growth in population, and technological process. Capital accumulation can be represented from the FDI inflow. Moreover, on this research

FDI inflow is an intervening or mediating variable that give effect to country's economic growth which can be seen from number of gross domestic product.

In general, conceptual framework of this research can be write down on the function below and can be seen in the figure 3.1.

FDI = f (Governance Quality, Tax Holiday)

Economic Growth = f (FDI)



Source: Author summary

Figure 3.1 Conceptual Framework

1.2. Hypotheses

According to Creswell (2014), quantitative hypotheses are predictions that the researcher makes about the expected outcomes of relationships among variables. This predictions is about what the researcher expects the results to show. They are numeric estimation of population values based on data collected from samples.

The hypotheses of this research are:

H1: Voice & Accountability has significant effect on Foreign Direct Investment

H2: Political stability and absence of violence/Terrorism has significant effect on Foreign Direct Investment

H3: Government effectiveness has significant effect on Foreign Direct Investment

H4: Regulatory quality has significant effect on Foreign Direct Investment

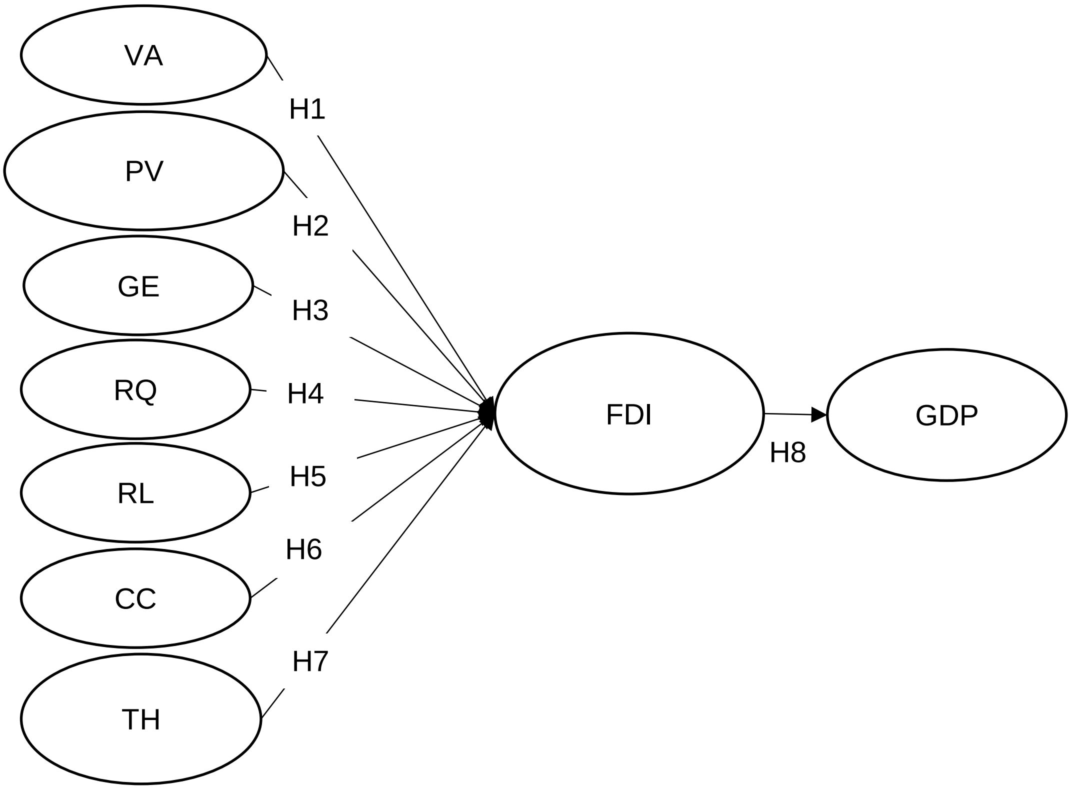
H5: Rule of law has significant effect on Foreign Direct Investment

H6: Control of Corruption has significant effect on Foreign Direct Investment

H7: Tax holiday has significant effect on Foreign Direct Investment

H8: Foreign Direct Investment has significant effect on Economic Growth

The hypotheses model of this research can be seen in figure below:



Source: Author summary

Figure 3.2 Research Model

VA = Voice and Accountability

PV = Political Stability and Absence of Violence/Terrorism

GE = Government Effectiveness

RQ = Regulatory Quality

RL = Rule of Law

CC = Control of Corruption

TH = Tax Holiday

FDI = Foreign Direct Investment

GDP = Gross Domestic Product