

## Tax Incentives And Foreign Investment Attractiveness: Evaluation Of Effectiveness On FDI Levels In National GDP

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### Abstract

This study evaluates the effectiveness of tax incentives in attracting Foreign Direct Investment (FDI) to Indonesia and their contribution to Gross Domestic Product (GDP). FDI plays a crucial role in economic growth by providing capital, technology transfer, and job creation. To enhance investment attractiveness, the government has introduced various fiscal facilities, including tax holidays, tax allowances, and incentives in Special Economic Zones. Using a qualitative descriptive method with a case study approach, this research analyzes secondary data from 2020–2023. The findings indicate that Indonesia's FDI-to-GDP ratio remains low, between 1.5% and 1.9%, thus limiting its impact on economic growth. A comparison with other ASEAN countries highlights that non-fiscal factors such as political stability, regulatory certainty, infrastructure, and human capital quality are more influential in investment decisions than tax policy alone. Therefore, tax incentives should be complemented with structural reforms to strengthen the investment climate and maximize FDI's economic impact.

**Keywords:** *foreign direct investment, GDP, Indonesia, investment climate, tax incentives*

JEL Codes : H25, F21

### INTRODUCTION

**Foreign Direct Investment (FDI)** is widely recognized as one of the key pillars and primary drivers of economic growth, particularly for developing countries such as Indonesia. FDI serves not only as a vital source of capital for financing infrastructure projects and productive sectors but also as a strategic channel for technology transfer, knowledge development, the adoption of modern management practices, and the improvement of operational efficiency (Maulidina, 2017). Through the entry of foreign enterprises, productivity and efficiency are enhanced, while the host country's technological capacity is strengthened, fostering innovation and improving the competitiveness of local businesses. In addition, FDI contributes to significant job creation, productivity growth, and, in turn, the increase of national income.

As a developing country with a large market potential, Indonesia relies heavily on foreign investment to support infrastructure development, generate employment, and enhance technology transfer. To attract foreign capital inflows, the Indonesian government has implemented various policies, one of which is the provision of tax incentives. These incentives include the **Tax Holiday** (corporate income tax exemption for a certain period) granted to pioneer industries, and the **Tax Allowance** (reduction of taxable income, accelerated depreciation, and dividend tax reduction) for specific sectors, aimed at reducing investors' financial burdens and increasing Indonesia's attractiveness as an investment destination. Other measures include the reduction of corporate income tax rates and the provision of tax facilities in Special Economic Zones (SEZs).

Despite the implementation of various tax incentives, their effectiveness in boosting FDI realization in Indonesia remains a subject of debate and has not yet reached its full potential. However, such incentives may also pose risks by potentially burdening the economy and society if not properly managed (Lutfi, A. B., 2024). This indicates that other factors beyond tax incentives also influence investors' decisions. In 2016, the Ministry of Industry stated that the utilization of fiscal incentives such as the Tax Holiday was still considered suboptimal.

This situation is attributed to several key factors that affect investment attractiveness, including the importance of political stability and effective governance in creating a favorable investment climate.

Adequate infrastructure availability such as transportation, energy, and telecommunications also plays a crucial role, as reflected in the greater impact of FDI in Java, where infrastructure is more developed compared to regions outside Java. Moreover, the quality of human resources and the availability of skilled labor are vital considerations for investors. Macroeconomic stability, including low inflation rates and consistent monetary policies, is equally essential; indeed, research indicates that inflation and unemployment rates exert a negative influence on economic growth. Additional challenges stem from the need for bureaucratic and regulatory reforms to establish a more conducive business environment.

Given the complexity of factors influencing foreign investment and the evolving landscape of global taxation, this study aims to comprehensively evaluate the effectiveness of Indonesia's tax incentives on the level of FDI in the national GDP. The research will analyze the extent to which existing tax incentives contribute to attracting foreign investment, while also identifying other factors that either hinder or support FDI inflows and their contribution to Indonesia's economic growth particularly in the context of stability and competitiveness compared to other countries.

## LITERATURE REVIEW

Tax incentives are fiscal policies designed by governments to reduce taxpayers' burdens in order to stimulate strategic economic activities such as investment, job creation, and technological development. In Indonesia, common forms include tax holidays (corporate income tax exemption), tax allowances (deductions, accelerated depreciation, and dividend tax reduction), and facilities in Special Economic Zones (SEZs). These incentives aim to attract both domestic and foreign investment, particularly in priority sectors, by increasing net returns and lowering capital costs. This aligns with the Laffer Curve principle, which suggests that lower tax rates can foster growth and investment while maintaining long-term state revenue (Maulidina, 2017).

Foreign Direct Investment (FDI) represents long-term capital inflows accompanied by technology transfer, managerial expertise, and knowledge that significantly contribute to economic development (Salvatore, 2014). For developing countries like Indonesia, FDI is vital for accelerating growth, creating employment, and enhancing productivity. While fiscal incentives help reduce investors' burdens, non-fiscal factors such as legal certainty, political stability, infrastructure, bureaucracy, and skilled labor often weigh more heavily in investors' decisions. Conversely, policy uncertainty, corruption, and administrative barriers tend to discourage investment.

Gross Domestic Product (GDP) serves as a central indicator of a nation's economic performance, reflecting the total value of goods and services produced within a period (Ardini, 2024). Both Keynesian and Harrod-Domar theories emphasize investment as a driver of GDP growth, with FDI playing a strategic role by expanding production capacity, creating jobs, and boosting exports. Nevertheless, GDP dynamics are also shaped by macroeconomic factors including interest rates, inflation, exchange rates, and monetary policy, as well as by institutional reforms that ensure a conducive business environment.

The interplay between tax incentives, FDI, and GDP is therefore complex. Tax incentives are designed to attract FDI, while FDI contributes to GDP growth through capital accumulation, technology transfer, and consumption expansion. Rising GDP, in turn, enhances a country's attractiveness to further investment. However, empirical findings suggest that this relationship is not always linear or significant, as structural challenges like weak governance, corruption, and bureaucratic inefficiency may undermine the effectiveness of incentives (Angellyta, 2025). Accordingly, non-fiscal factors remain critical in sustaining FDI inflows. Political stability, strong legal frameworks, reliable infrastructure, transparent regulation, and macroeconomic stability including controlled inflation and stable exchange rates are decisive elements in ensuring that investment contributes to sustainable economic growth.

## RESEARCH METHOD

This research is a descriptive quantitative study that aims to evaluate fiscal policy in the form of tax incentives in Indonesia. A quantitative approach is employed using secondary data to assess the effectiveness of such policies in attracting Foreign Direct Investment (FDI) and their impact on the national economy. The focus of this study lies in examining tax incentive policies targeted at foreign

investors. The assessment is conducted to evaluate the effectiveness of these policies in promoting FDI inflows and their contribution to Gross Domestic Product (GDP) growth.

The data used in this research are secondary data, which have been collected by other parties for purposes different from this study. Sources include books, scientific journals, previous research, government policy documents, official reports, and relevant media articles. Data collection was carried out through document and literature review, with a focus on the implementation of tax incentive policies in recent years. This study is cross-sectional, as the data are analyzed within a specific time frame, covering four years from 2020 to 2023.

Data analysis was conducted descriptively, paying attention to the trends of FDI inflows and changes in economic indicators during the period under review. This research does not utilize micro-level data by sector or policy but instead relies on aggregated macroeconomic data to capture general patterns.

It should be noted that one of the **limitations** of this study lies in the use of **FDI-to-GDP data** sourced from the Macrotrends platform. Since the data are presented at the national aggregate level, it does not allow for the identification of the direct impact of specific tax incentive policies, such as the Tax Holiday or Tax Allowance. Therefore, the analysis is conducted by considering the time context and the trends that emerged during the implementation of these policies.

## RESULTS AND DISCUSSION

Tax incentives are one of the fiscal policy instruments used by the government to attract investment, both domestic and foreign. By providing certain tax facilities, the government seeks to reduce the tax burden borne by businesses, thereby enhancing the competitiveness of national investment. These incentives include various facilities such as the Tax Holiday, Tax Allowance, Tax Holiday in Special Economic Zones (SEZs), Tax Allowance in SEZs, Investment Allowance, Super Tax Deduction for Vocational Activities, and Super Tax Deduction for Research and Development (R&D). According to the Central Government Financial Report (LKPP) 2023, the provision of tax incentives has reached various strategic sectors and is distributed across multiple regions. Since the issuance of Minister of Finance Regulation (PMK) No. 130/PMK.010/2020 on September 18, 2020, these facilities have been utilized by hundreds of companies, both in pioneer industries and in special economic zones.

Table 1  
 Penetration of Tax Incentives in Indonesia

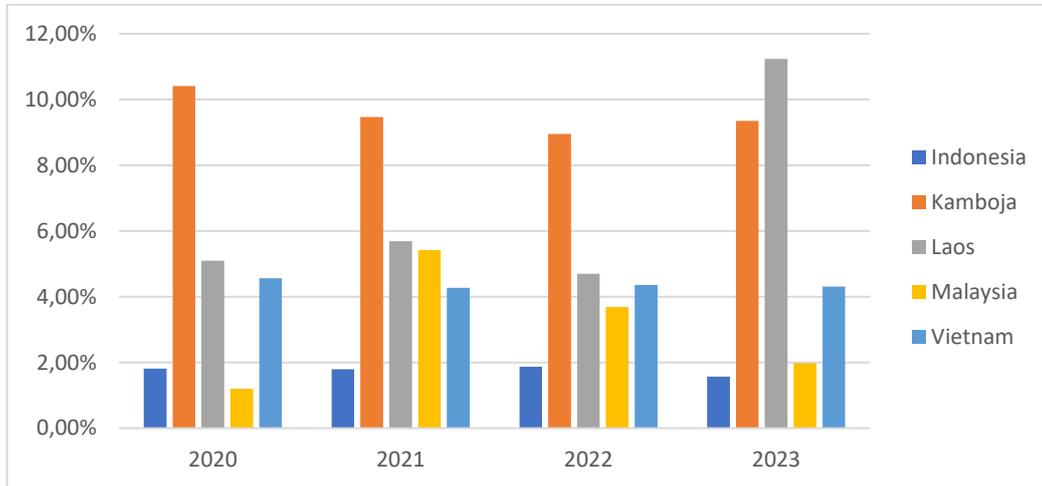
| No | Jenis Fasilitas             | 2020 | 2021 | 2022 | 2023 |
|----|-----------------------------|------|------|------|------|
| 1. | Tax Holiday                 | 25   | 23   | 34   | 19   |
| 2. | Tax Allowance               | 34   | 17   | 16   | 11   |
| 3. | Tax Holiday di KEK          | 0    | 12   | 4    | 11   |
| 4. | Tax Allowance di KEK        | 0    | 1    | 3    | 1    |
| 5. | Investment Allowance        | 2    | 3    | 2    | 2    |
| 6. | Super Tax Deduction Vokasi  | 23   | 34   | 37   | 32   |
| 7. | Super Tax Deduction Litbang | 0    | 24   | 6    | 10   |

(Source: LKPP 2023 Audited)

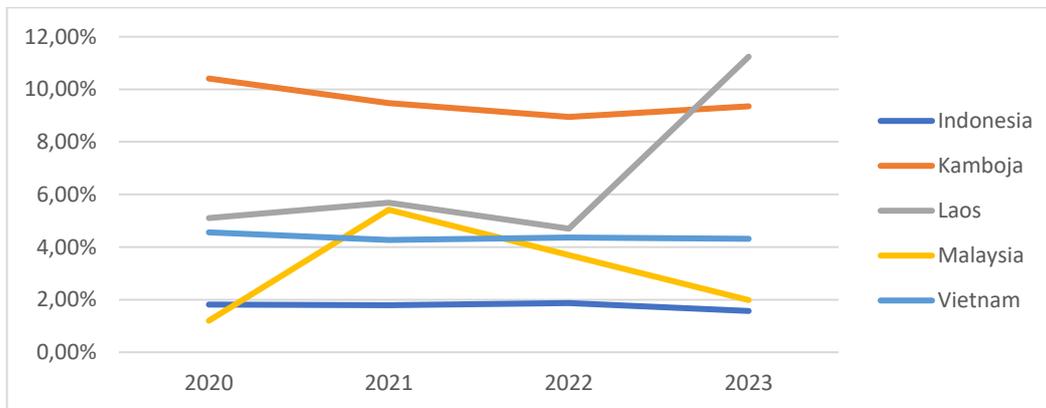
In Minister of Finance Regulation (PMK) No. 130 of 2020, it is stated that tax incentive facilities in the form of corporate income tax reductions (tax holidays) are granted to companies or entities operating in pioneer industries. This category includes upstream basic metal industries, oil and gas refining industries, petrochemical industries based on oil, gas, and coal, as well as other strategic sectors that play a role in strengthening the national industrial structure.

The primary objective of the government in implementing this policy is to stimulate economic growth by increasing business activity and attracting investment, particularly Foreign Direct Investment (FDI). The application of tax incentives may take the form of sales tax exemptions for a specific period to stimulate consumption, or corporate income tax exemptions for newly established companies investing in strategic sectors. In Southeast Asia, countries such as Indonesia, Malaysia, Cambodia, Laos, and Vietnam have adopted this scheme to attract FDI by granting tax exemptions to investors who allocate capital in priority regions or sectors.

To provide a clearer picture of the effectiveness of tax incentives in attracting foreign investment in the Southeast Asian region, particularly in Indonesia, a comparison of data from several ASEAN countries that have implemented such policies is presented below. The chart illustrates the trend of Foreign Direct Investment (FDI) before and after the implementation of tax incentives in these countries. This data indicates the extent to which tax incentive policies contribute to increasing FDI inflows in countries such as Indonesia, Malaysia, Thailand, and Vietnam, which serve as strategic investment destinations in the region.

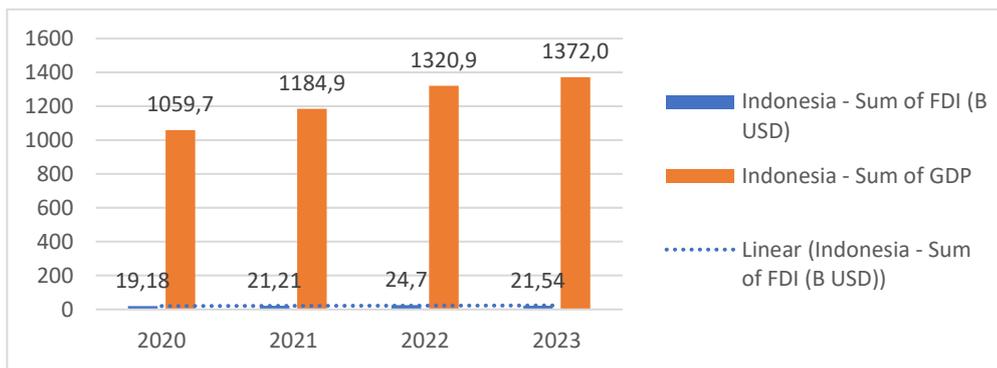


Source: Macrotrends (FDI to GDP), data processed by the author  
Figure 2. FDI to GDP of Several ASEAN Countries



Source: Macrotrends (FDI to GDP), data processed by the author.  
Figure 3. FDI to GDP Statistics for Several ASEAN Countries

Based on FDI-to-GDP ratio data for five ASEAN countries during the 2020–2023 period, Cambodia consistently emerged as the largest FDI recipient with the highest percentage each year, although it experienced a decline from around 10.4% in 2020 to 9.0% in 2022, before slightly increasing again in 2023. Laos ranked second, recording a significant surge in 2023, reaching more than 11%, after previously remaining in the range of 4.9%–5.7%. Vietnam showed a stable trend within the range of 4.3%–4.7% throughout the period. Malaysia experienced considerable fluctuations, rising from 1.1% in 2020 to around 5.2% in 2021, before dropping to 1.9% in 2023. Meanwhile, Indonesia recorded the lowest ratio among the five countries, remaining stable at around 1.5%–1.9% without significant changes during the observation period. The comparison between total FDI inflows and GDP in Indonesia is illustrated as follows.



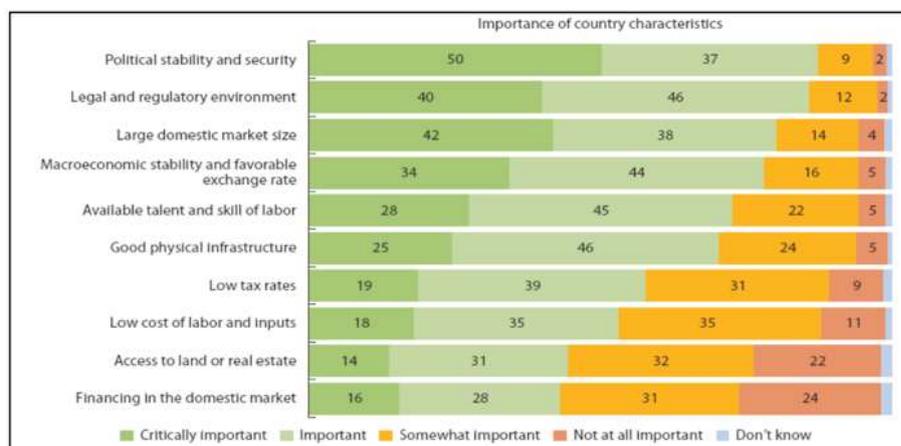
Source: Macrotrends (FDI to GDP), data processed by the author.

Figure 4. Comparison of FDI Inflows and GDP Value

Based on the data presented in the chart, it is evident that Indonesia’s Foreign Direct Investment (FDI) values during the 2020–2023 period remained relatively low compared to its Gross Domestic Product (GDP). FDI values were only in the range of USD 19–25 billion per year, while GDP stood above USD 1 trillion and continued to increase, from USD 1,059.7 billion in 2020 to USD 1,372.0 billion in 2023. Consequently, Indonesia’s FDI-to-GDP ratio remained within 1.5%–1.9%, far below the expected contribution of foreign direct investment to the national economy. Although the government has implemented tax incentive policies to attract foreign investors, the trend of incoming FDI did not show a significant increase. In fact, in 2023, FDI values declined compared to 2022, even though GDP continued to grow. This indicates that tax incentives alone are not sufficient to trigger a substantial surge in foreign investment.

The low contribution of FDI to GDP suggests that structural challenges remain to be addressed, such as regulatory uncertainty, complex bureaucracy, uneven infrastructure quality across regions, and a competitiveness level that lags behind other ASEAN countries such as Vietnam and Cambodia. These countries have managed to attract larger FDI inflows through regulatory reforms, accelerated infrastructure development, and improvements in investment cost efficiency. This situation highlights the need for Indonesia to complement its tax incentive policies with other strategic measures, such as improving the investment climate, streamlining business licensing, and strengthening infrastructure, in order to achieve FDI growth targets and ensure a more significant contribution to the economy.

Foreign investors’ choice of investment destination is influenced by several key factors. According to the GIC Survey and the World Bank, the most important aspects include political stability, legal and regulatory certainty, infrastructure, and labor costs. These factors serve as critical foundations in assessing the effectiveness of tax incentives in attracting Foreign Direct Investment (FDI) to Indonesia.



Sumber: GIC Survey, World Bank

Figure 5. Factors Determining Investment Decisions

Based on chart data from the GIC World Bank Survey, the most crucial factors for investors are political stability and security, followed by legal and regulatory certainty, as well as the size of the domestic market. Meanwhile, factors such as low tax rates and cheap labor costs are considered important, but they rank below political, legal, and market-related aspects. This indicates that although tax incentives may serve as an attraction, investment decisions are still more strongly influenced by fundamental factors such as stability, legal certainty, and market potential.

Legal certainty in the implementation of tax incentives in Indonesia remains one of the main issues affecting foreign investors' interest. Frequent regulatory changes, both at the level of laws and implementing regulations, make such policies difficult to predict in the long term. For instance, the provision on tax incentives (tax holidays) that was previously regulated under the Investment Law was later removed through the Omnibus Law on Job Creation (2023). On the other hand, implementing regulations such as the Minister of Finance Regulations (PMK) have also undergone frequent revisions in a short period, such as PMK No. 35/PMK.010/2018 being replaced by PMK No. 150/PMK.010/2018, and later revised again by PMK No. 130/PMK.010/2020. These conditions create uncertainty and reduce investor confidence in the consistency of Indonesia's fiscal policies, especially when compared to ASEAN countries that tend to demonstrate greater regulatory stability. Moreover, the complexity of business classification (KBLI) and the need to comply with international standards such as the Global Minimum Tax (GMT) further add to the challenges, thereby limiting the effectiveness of tax incentives in attracting foreign investment.

Inefficient bureaucracy also poses a significant obstacle in the implementation of tax incentives in Indonesia. This highlights that the success of a tax incentive regime is highly dependent on investor confidence, which in turn is shaped by transparency, legal certainty, and accountability. However, the rules concerning eligibility criteria, applicable rates, and duration of tax incentives remain unclear, creating uncertainty and weakening investment attractiveness.

Regulatory uncertainty and frequent policy changes drive investors to favor other countries that offer more stable fiscal regimes. Therefore, the government needs to enforce regulatory consistency, align policies with international standards such as the Global Minimum Tax (GMT), and simplify bureaucracy through transparency and digitalization. Furthermore, strong law enforcement and anti-corruption measures are essential in building investor trust.

With improvements in legal certainty, administrative efficiency, and bureaucratic integrity, the effectiveness of tax incentives can be strengthened, thereby attracting greater FDI inflows and contributing to Indonesia's national economic growth.

## CONCLUSION AND SUGGESTION

This study finds that tax incentive policies in Indonesia have not been fully effective in attracting foreign investment. Although facilities such as tax holidays and tax allowances provide some stimulus, the contribution of FDI to Indonesia's GDP during the 2020–2023 period remained low, at only around 1.5–1.9 percent, thereby limiting its impact on economic growth.

The analysis also shows that non-tax factors play a more dominant role in shaping investor interest. Political stability, legal certainty, infrastructure, human capital quality, and sound macroeconomic conditions are proven to influence FDI inflows more strongly than fiscal incentives alone. Therefore, tax incentives must be complemented by structural reforms in order to significantly enhance FDI's contribution to GDP.

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