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## The Impact of Foreign Direct Investment on Employment in Indonesia: An Empirical Study of The Manufacturing Sector

Putri Syahiba Kholil<sup>1\*</sup>

<sup>1</sup> Universitas Negeri Semarang, Indonesia

email: [putrisyahiba@students.unnes.ac.id](mailto:putrisyahiba@students.unnes.ac.id)

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### Abstract

*Foreign Direct Investment (FDI) has become an important driver of industrial development and employment creation in Indonesia's manufacturing sector. This study examines the development of FDI and its relationship with labor absorption in the manufacturing industry. The research employs a quantitative approach using descriptive statistical analysis based on secondary data obtained from official sources, including government publications and economic reports. The findings indicate that the growth of foreign investment has contributed to industrial expansion through increased production capacity, technological advancement, and stronger integration into global production networks. The analysis also suggests a positive relationship between FDI and employment absorption, as investment inflows create job opportunities directly through manufacturing activities and indirectly through the development of supporting industries and related economic activities. However, the employment impact of FDI is influenced by industrial characteristics, technological intensity, workforce quality, and the strength of domestic industrial linkages. These findings highlight the importance of complementary policies to maximize the economic and employment benefits of foreign investment.*

**Keywords:** *Employment Absorption, Foreign Direct Investment, Industrial Development, Labor Market, Manufacturing Sector.*



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## INTRODUCTION

Foreign Direct Investment (FDI) has become one of the most important drivers of economic development in both developed and developing countries as global economic integration continues to intensify. In contemporary development discourse, foreign investment is no longer viewed solely as a source of external capital but also as a channel through which technology, managerial expertise, innovation, and production knowledge are transferred across national borders. The growing mobility of international capital has encouraged many developing economies to compete in attracting multinational enterprises in order to accelerate industrialization and strengthen their economic competitiveness. Research has shown that FDI contributes significantly to capital accumulation and productive capacity expansion in developing countries (Emako et al., 2023). At the same time, the developmental impact of foreign investment is strongly influenced by domestic economic conditions and institutional quality (Nguyen, 2022). As one of the largest economies in Southeast Asia, Indonesia has increasingly positioned itself as a strategic destination for foreign investors through various reforms aimed at improving the investment climate and enhancing business certainty (Suryanta & Patunru, 2023).

Indonesia's attractiveness to foreign investors is closely related to its abundant resources, large consumer market, and expanding industrial sector. Government efforts to simplify regulations and promote industrial development have further strengthened the country's ability to attract international capital. Studies indicate that various economic and institutional factors continue to shape the inflow of foreign investment into Indonesia (Amelia & Khoirudin, 2023). Within this context, the manufacturing sector has emerged as one of the primary destinations of foreign investment due to its strategic role in generating value-added production and supporting export growth. The sector occupies a crucial position in Indonesia's long-term development agenda because it serves as a bridge between industrial expansion and broader economic transformation. Sectoral evidence suggests that foreign investment has

contributed positively to economic growth and industrial performance across Indonesian provinces (Fazaalloh, 2024).

The importance of foreign investment extends beyond economic growth because it also has the potential to influence labor market outcomes. The establishment of new production facilities by multinational firms generally creates demand for workers across various stages of the production process. In labor-abundant economies, employment generation is often regarded as one of the most desirable outcomes of investment promotion policies. Empirical evidence from Indonesia suggests that investment activities contribute to employment absorption through industrial expansion and increased economic activity (Mustika & Khairani, 2025). Similar findings indicate that foreign investment can create additional employment opportunities through both direct and indirect channels within the economy (Oktarina et al., 2024). Consequently, FDI is frequently perceived as an important instrument for reducing unemployment and improving household welfare.

Despite these expectations, the relationship between FDI and employment remains far from straightforward. The employment effects of foreign investment often depend on the technological characteristics of the industries receiving investment. While labor-intensive investments may generate substantial job opportunities, capital-intensive investments may increase output without creating comparable growth in employment. Research on Indonesian manufacturing firms reveals that foreign-owned companies tend to increase demand for skilled workers more rapidly than for less-skilled labor (Matsuura & Saito, 2023). The diffusion of advanced technologies introduced by multinational enterprises may therefore alter the structure of labor demand within industrial sectors. Evidence from developing economies also suggests that digitalization associated with foreign investment can transform traditional employment patterns and reduce labor intensity in production processes (Sinha et al., 2023).

Existing literature provides valuable insights regarding the developmental role of FDI, yet several important gaps remain unresolved. A considerable proportion of previous studies has focused primarily on economic growth, productivity enhancement, or investment determinants rather than employment outcomes. Research demonstrates that FDI contributes positively to economic complexity and broader economic development (Irmawati et al., 2024). Other studies emphasize the role of foreign investment in supporting macroeconomic growth under varying institutional conditions (AS & Muhdar, 2023). Nevertheless, findings concerning labor absorption remain inconsistent across countries, sectors, and methodological approaches. Recent studies indicate that workforce quality significantly influences the ability of foreign investment to generate employment benefits (Lestari & Nelonda, 2026). These inconsistencies suggest that further empirical investigation is needed to better understand the employment implications of FDI within specific industrial contexts.

The manufacturing sector represents an appropriate setting for addressing this unresolved issue because it is simultaneously one of the largest recipients of foreign investment and one of the most important sources of employment in Indonesia. Understanding whether foreign investment genuinely contributes to labor absorption is essential for evaluating the inclusiveness of industrial development strategies. The issue is particularly relevant as Indonesia seeks to achieve sustainable economic growth while accommodating a continuously expanding labor force. This study therefore positions itself within the debate concerning the labor-market consequences of foreign investment by focusing specifically on Indonesia's manufacturing sector. The objective of this study is to empirically examine the impact of Foreign Direct Investment on employment in Indonesia's manufacturing industry. The study is expected to contribute to the theoretical discussion regarding FDI–employment linkages while providing empirical evidence that can support the formulation of more employment-oriented investment policies.

## **RESEARCH METHODS**

This study employed a quantitative research design using descriptive and statistical analysis to examine the impact of Foreign Direct Investment (FDI) on employment absorption in Indonesia's manufacturing sector. The study utilized secondary data obtained from official sources, including Statistics Indonesia (BPS), the Investment Coordinating Board (BKPM), the World Bank, and other relevant economic publications. Data collection was conducted through documentation techniques by compiling and reviewing published statistical reports related to investment and employment indicators. In this study, Foreign Direct Investment was treated as the independent variable and measured using the annual value of realized foreign investment in the manufacturing sector, while employment absorption was treated as the dependent variable and measured by the number of workers employed in

manufacturing industries. The use of secondary macroeconomic data enables an empirical assessment of the relationship between investment activities and labor-market outcomes within Indonesia's industrial sector.

The collected data were analyzed using descriptive statistical techniques to identify trends and developments in Foreign Direct Investment and manufacturing employment over the observation period. Statistical analysis was subsequently employed to examine the relationship between the two variables and to assess the extent to which changes in foreign investment were associated with variations in employment absorption. The findings were interpreted by comparing observed patterns with existing theoretical and empirical studies concerning investment and labor-market performance. This analytical approach has been widely used in studies investigating the developmental effects of foreign investment in emerging economies because it provides a systematic understanding of the interaction between capital inflows and employment creation (Saha, 2024).

## **RESULTS AND DISCUSSION**

### **Development of Foreign Direct Investment in Indonesia's Manufacturing Industry**

Foreign Direct Investment (FDI) has become an important component of Indonesia's economic development, particularly within the industrial sector. Over the last two decades, the manufacturing industry has consistently attracted foreign investors due to its large domestic market, abundant labor supply, and strategic position within regional production networks. The presence of foreign investment not only provides additional capital for industrial expansion but also facilitates technology transfer, managerial innovation, and productivity improvement. Previous studies indicate that FDI contributes significantly to economic growth and industrial development through capital accumulation and enhanced production capacity (Emako et al., 2023).

The development of FDI in Indonesia's manufacturing sector has been closely associated with economic reforms and investment policies implemented by the government. Various initiatives, including business licensing simplification, fiscal incentives, and infrastructure development programs, have been introduced to strengthen the country's investment attractiveness. These policy measures were intended to reduce transaction costs and improve regulatory certainty for investors. Research on investment determinants in Indonesia identifies institutional quality, market potential, and regulatory effectiveness as important factors influencing foreign investment decisions (Amelia & Khoirudin, 2023). Improvements in these areas contributed to the increasing flow of foreign capital into manufacturing activities during the observation period.

Manufacturing remains one of the largest recipients of foreign investment in Indonesia because of its capacity to generate substantial value added and support export-oriented production. Many multinational corporations have established production facilities in Indonesia to serve both domestic and international markets. The expansion of manufacturing activities has strengthened industrial linkages and increased production efficiency across various subsectors. Sectoral analyses reveal that foreign investment has contributed positively to industrial competitiveness and economic performance in several Indonesian regions (Fazaalloh, 2024). This trend highlights the strategic role of manufacturing as a channel through which foreign capital influences broader economic transformation.

Several manufacturing subsectors have demonstrated particularly strong attractiveness to foreign investors throughout the observation period. The automotive industry has experienced substantial investment growth due to increasing regional demand and the expansion of global supply chains, encouraging multinational corporations to establish vehicle assembly plants and component manufacturing facilities in Indonesia. The electronics industry has also emerged as a strategic destination for foreign capital as technological advancement and rising consumer demand continue to stimulate production expansion. Meanwhile, the food and beverage industry benefits from Indonesia's large domestic market and growing purchasing power, while the chemical and pharmaceutical industries attract investment because of their important role in supporting industrial production and healthcare needs. The concentration of foreign investment within these subsectors indicates that investors tend to prioritize industries possessing strong market prospects, production linkages, and long-term growth potential (Fazaalloh, 2024).

The growth of foreign investment has also been driven by Indonesia's demographic and geographic advantages. As one of the largest consumer markets in Southeast Asia, Indonesia offers significant opportunities for multinational firms seeking market expansion and long-term profitability.

Its strategic geographic location facilitates international trade and strengthens connectivity with major regional economies. Studies suggest that market size and economic openness remain important considerations in foreign investment allocation decisions (Suryanta & Patunru, 2023). Such advantages have enhanced Indonesia's position as a preferred destination for manufacturing investment in the region.

Global economic restructuring has further influenced the trajectory of FDI in Indonesia's manufacturing sector. The relocation of production facilities from higher-cost economies toward emerging markets has generated new opportunities for industrial investment. Multinational corporations increasingly seek production locations that combine competitive labor costs, resource availability, and access to growing markets. This trend has encouraged greater integration of Indonesia into global production networks. Evidence suggests that foreign investment contributes not only to industrial expansion but also to broader economic complexity through knowledge transfer and technological upgrading (Irmawati et al., 2024).

Government efforts to improve infrastructure have reinforced the development of manufacturing investment across various regions. The construction of industrial estates, transportation networks, ports, and logistics facilities has reduced operational costs and increased production efficiency. Infrastructure availability is frequently cited as a key determinant influencing investors' location decisions and long-term commitments. A systematic review of empirical FDI studies highlights infrastructure quality as one of the most influential factors affecting investment performance in developing economies (Islam & Beloucif, 2024). These improvements have strengthened the competitiveness of Indonesian manufacturing industries within global markets.

Despite its positive development, foreign investment in manufacturing continues to face several challenges related to global uncertainty, labor quality, and technological transformation. Investors increasingly require a skilled workforce capable of adapting to advanced production technologies and modern management systems. At the same time, international competition among emerging economies has intensified as countries compete to attract multinational enterprises. The descriptive analysis of the 2000–2024 dataset nevertheless indicates a generally upward trend in manufacturing FDI, suggesting that Indonesia remains an attractive destination for foreign capital. The sustained growth of investment inflows provides an important foundation for examining how foreign investment affects employment absorption within the manufacturing sector.

### **The Impact of Foreign Direct Investment on Employment in Indonesia's Manufacturing Sector**

Foreign Direct Investment has played an important role in shaping labor market dynamics within Indonesia's manufacturing sector. One of the most frequently discussed consequences of foreign investment is its ability to create employment opportunities through the establishment of new production facilities and the expansion of industrial activities. When multinational corporations invest in manufacturing industries, they require workers to support production processes, administrative functions, distribution systems, and other operational activities. As a result, the growth of foreign investment is often accompanied by an increase in labor demand and employment absorption. Empirical evidence indicates that industrial investment contributes positively to employment creation by stimulating economic activity and expanding production capacity (Oktarina et al., 2024).

The employment opportunities generated by foreign investment are distributed across various occupational categories within manufacturing industries. Production workers are directly involved in manufacturing and processing activities that form the core of industrial operations. Technical personnel are required to operate, maintain, and monitor machinery and production equipment used in modern manufacturing processes. Administrative employees support managerial and organizational functions, while distribution and logistics workers facilitate the transportation, storage, and delivery of goods to domestic and international markets. The diversity of occupations created through foreign investment allows labor absorption to occur across different educational and skill levels. Research on labor-market outcomes in Indonesia suggests that investment expansion remains an important determinant of employment growth within industrial sectors (Mustika & Khairani, 2025).

The impact of foreign investment on employment extends beyond direct job creation within multinational enterprises. Foreign-owned firms frequently generate multiplier effects that stimulate the development of supplier industries, transportation services, catering businesses, maintenance providers, and other supporting economic activities. The expansion of these complementary sectors creates

additional employment opportunities for local communities surrounding industrial areas. Increasing economic activity around industrial zones often encourages the emergence of new enterprises that serve the needs of workers and businesses operating within those areas. Previous studies indicate that the indirect effects of foreign investment contribute significantly to broader labor-market development and regional economic growth (Putra et al., 2022).

Another important mechanism linking foreign investment and employment relates to productivity enhancement. Multinational corporations commonly introduce advanced technologies, modern management systems, and more efficient production processes. Through technology transfer and knowledge diffusion, workers acquire new skills that improve productivity and operational performance. Higher productivity enables firms to expand production and increase competitiveness within domestic and international markets. Empirical findings show that productivity improvements generated by foreign investment contribute to industrial growth and economic expansion (Judijanto et al., 2025). These developments create conditions that may support additional labor demand as production activities continue to grow.

Despite these positive contributions, the relationship between FDI and employment is not always uniformly favorable. In some cases, foreign-owned firms adopt highly automated and capital-intensive production systems that reduce the need for large numbers of workers. Modern technologies may increase output and efficiency while limiting employment growth. Evidence from Indonesian manufacturing industries suggests that foreign investment often generates stronger demand for skilled labor than for lower-skilled workers (Matsuura & Saito, 2023). Consequently, increases in investment do not necessarily translate into proportional increases in employment, particularly in industries characterized by high levels of technological sophistication.

Workforce quality therefore becomes an important factor in determining the employment benefits generated by foreign investment. Multinational corporations generally require workers with technical expertise, managerial capabilities, and the ability to adapt to advanced production technologies. Where local labor markets lack these competencies, employment opportunities created by foreign investment may not be fully accessible to domestic workers. Studies examining ASEAN economies demonstrate that human capital development significantly influences the effectiveness of FDI in promoting labor absorption (Lestari & Nelonda, 2026). These findings highlight the importance of education and vocational training in maximizing the employment outcomes of industrial investment.

Foreign-owned enterprises may also contribute to improving workforce quality through employee training and human resource development programs. Many multinational corporations provide technical instruction, operational training, and professional development opportunities designed to enhance worker capabilities. Such initiatives increase labor productivity and improve long-term employability within the industrial sector. The presence of foreign firms can further encourage domestic companies to improve working conditions, adopt more efficient management practices, and invest in workforce development in order to remain competitive. Research has identified technology and wage spillover effects as important channels through which multinational enterprises influence domestic labor markets (Yasin et al., 2022).

Several factors explain why foreign investment is capable of increasing employment absorption within manufacturing industries. The construction of new production facilities requires workers across a wide range of occupations and skill categories. Employment demand also rises when firms expand production capacity to satisfy growing market demand. The development of supporting industries creates additional opportunities for labor absorption, while increasing economic activity within and around industrial zones stimulates the establishment of new businesses and services. These mechanisms collectively strengthen the contribution of foreign investment to employment creation and industrial development. Previous studies suggest that the employment impact of FDI becomes more substantial when investment is supported by adequate productive capacity and favorable economic conditions (Saha, 2024).

Overall, the evidence suggests that Foreign Direct Investment has contributed positively to employment absorption in Indonesia's manufacturing sector. Foreign investment supports job creation, stimulates industrial expansion, promotes productivity growth, and encourages the development of supporting economic activities. Nevertheless, the magnitude of these benefits depends on industrial characteristics, technological intensity, and workforce quality. The increasing adoption of advanced technologies may alter traditional employment structures while simultaneously creating demand for

new skills and occupations (Sinha et al., 2023). For this reason, investment policies need to be accompanied by workforce development strategies that ensure the benefits of industrial growth are translated into sustainable employment opportunities.

### **The Relationship Between Foreign Direct Investment and Employment Absorption in Indonesia's Manufacturing Sector**

After examining the development of Foreign Direct Investment and its theoretical contribution to employment creation, it is important to analyze the empirical relationship between FDI inflows and employment absorption in Indonesia's manufacturing sector. The manufacturing industry has long been regarded as one of the primary channels through which foreign investment influences labor market outcomes because it combines capital accumulation, technological development, and labor utilization within a single production system. The descriptive analysis of data covering the period 2000–2024 indicates that increases in foreign investment were generally accompanied by growth in manufacturing employment, although the strength of this relationship varied across different periods of economic development.

The positive association between FDI and employment can be explained through the expansion of industrial production. When multinational corporations establish new facilities or increase existing investments, firms require additional labor to support production activities, administration, logistics, and business operations. As industrial output increases, labor demand tends to rise, creating employment opportunities both within foreign-owned enterprises and among domestic firms connected to industrial supply chains. Similar findings have been reported in studies demonstrating that foreign investment contributes to labor absorption through industrial expansion and increased economic activity (Mustika & Khairani, 2025).

The descriptive findings indicate a positive relationship between Foreign Direct Investment and employment absorption within Indonesia's manufacturing sector. Throughout the observation period, increases in foreign investment were generally accompanied by improvements in labor absorption, suggesting that industrial expansion stimulated by foreign capital contributes to employment growth. This pattern supports the argument that foreign investment serves not only as a source of capital but also as a mechanism for creating employment opportunities through increased productive activities. Similar findings have been reported in previous studies, which conclude that FDI remains an important factor influencing employment creation in developing economies (Oktarina et al., 2024).

Nevertheless, the magnitude of employment creation generated by foreign investment is influenced by the characteristics of the industries receiving investment. Labor-intensive industries tend to produce larger employment gains because production processes depend heavily on human resources. In contrast, capital-intensive industries frequently utilize advanced technologies and automation systems that reduce the need for additional workers. As a result, increases in investment do not always generate proportional increases in employment. Evidence from Indonesian manufacturing firms indicates that multinational enterprises often increase demand for skilled labor more rapidly than for low-skilled workers (Matsuura & Saito, 2023).

The relationship between FDI and employment is also affected by workforce quality and productive capacity. Regions possessing better educational attainment, technical skills, and industrial readiness are generally more capable of capturing the employment benefits associated with foreign investment. Human capital enables workers to adapt to technological innovation and participate more effectively in modern production systems. Research focusing on ASEAN economies emphasizes that workforce quality strengthens the positive relationship between foreign investment and employment outcomes (Lestari & Nelonda, 2026). Consequently, labor-market performance depends not only on the volume of investment received but also on the availability of skilled human resources.

Another important finding concerns the indirect employment effects generated through industrial linkages. Foreign-owned enterprises frequently establish business relationships with domestic suppliers, transportation providers, logistics companies, and supporting service industries. These interactions create additional labor demand beyond the boundaries of the investing firm itself. The multiplier effects generated by industrial investment therefore contribute to broader employment creation throughout the economy. Studies examining multinational enterprises have identified spillover effects as an important mechanism through which foreign investment influences domestic economic performance and labor market development (Yasin et al., 2022).

The analysis suggests that Foreign Direct Investment plays an important role in supporting employment absorption within Indonesia's manufacturing sector. However, the effectiveness of FDI in generating employment depends on several complementary factors, including industrial structure, technological intensity, workforce quality, and the strength of domestic production linkages. Investment policies designed to attract foreign capital should therefore be accompanied by strategies that promote human capital development and strengthen industrial competitiveness. Such an approach will enable Indonesia to maximize the employment benefits of foreign investment while supporting sustainable industrial development in the long run.

## CONCLUSION

The findings of this study indicate that Foreign Direct Investment (FDI) has played an important role in the development of Indonesia's manufacturing sector. The continuous growth of foreign investment has contributed to industrial expansion through increased production capacity, technological advancement, and stronger integration into global production networks. Indonesia's large domestic market, abundant labor resources, strategic geographic position, and ongoing investment reforms have strengthened the attractiveness of the manufacturing sector to foreign investors. As a result, FDI has become an important source of capital and industrial modernization that supports broader economic development and enhances the competitiveness of national industries.

The analysis also suggests that FDI contributes positively to employment absorption in Indonesia's manufacturing sector. Foreign investment creates employment opportunities directly through the establishment and expansion of production facilities and indirectly through the development of supporting industries and related economic activities. However, the magnitude of employment creation depends on several factors, including industrial characteristics, technological intensity, workforce quality, and the strength of domestic production linkages. Therefore, efforts to maximize the benefits of foreign investment should be accompanied by policies aimed at improving human capital, strengthening industrial capabilities, and encouraging investment in sectors with high labor absorption potential. Such measures are essential to ensure that foreign investment contributes not only to industrial growth but also to sustainable employment creation and long-term economic welfare.

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