ABSTRACT

International trade and capital movement plays important role in economic development. The relation of both is among debated issues in international economics. Following Heckscher-Ohlin Model, Mundell (1957) suggests that trade is a substitute for capital movements. In contrast, Markusen (1983) suggest that both are complementary. Schiff (2006) proposes that tariff defines the relationship.

The research attempted to analyze the relation between trade and foreign direct investment in Indonesia. In specific, the research investigated the causal relationship between international trade and capital movement and the nature of relationship.

The research employed a quarterly time series data covering period of 2000 to 2013. The data are collected from Capital Investment Coordinating Board of Indonesia (BKPM) and International Financial Statistic (IFS). The analysis were conducted within a Time Series Econometrics Method, i.e. Granger Causality and Vector Error Correction Model (VECM).

The estimation result shows that international trade has a one way causality relationship with FDI. International trade does Granger Caused FDI whereas FDI does not Granger Caused international trade. The result also shows that in the long run trade and FDI are complement. This suggest an increase in trade implying an increase in FDI, vice versa.

Keywords: International trade, the flow of direct investment, VECM, Granger Causality

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