

Foreign Direct Investment and Corruption Perception Index in Asean-5 Countries



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ABSTRACT: This study's goal is to examine the connection between foreign direct investment (FDI) and Corruption Perception Index (CPI) in ASEAN-5 including the Philippines, Indonesia, Malaysia, Thailand, and Vietnam, during the period 2001-2019. Furthermore, we examine the link between FDI and macroeconomics variables, such as Gross Domestic Product (GDP) and Interest Rates. Panel data with a fixed effect model (FEM) are used in this investigation to examine the relationship between variables. The findings of this investigation suggest that the corruption perception index and gross domestic product have an impact on foreign direct investment that is both positive and significant. Meanwhile, foreign direct investment is significantly and negatively impacted by interest rates.

KEYWORDS: Foreign Direct Investment; Corruption Perception Index; Gross Domestic Product; Interest Rate.

JEL Classification: E31, E52, F31.

1. INTRODUCTION

Developing countries need capital to accelerate their economic development. However, in developing countries there is a serious shortage of capital stock and the rate of formation of money capital to advance the country's economy (Mohsin, 2021). Countries with limited capital will result in low economic productivity which results in low people's income. Low income will also affect the limited savings needed for investment in the future. Developing countries have common characteristics including that they lack capital and have low levels of investment and savings (Anwar et al., 2023). Increasing capital growth is not enough to mobilize domestic savings funds through public loans and taxes. In addition, technological backwardness is also a characteristic of developing countries, as evidenced by the high average production and low capital productivity due to the lack of renewal of capital equipment and the unskilled workforce. Therefore, foreign investment is needed in accelerating the economic development in developing countries (Suhendra, et al. 2020)

Capital flow funds foreign investment moved to the private sector through Foreign Indirect Investment (FII) and Foreign Direct Investment (FDI). FII is an investment related to financial assets, such as stocks, bonds, and others. This type of investment can directly affect the balance of payments or exchange rates, in terms of income or production. However, this capital does not include an element of ownership. Meanwhile, FDI is an investment that includes an element of ownership. These investments are usually in the form of physical assets such as land and factories as well as company management. Some researchers consider Foreign Direct Investment to be more profitable than portfolio investment. FDI is considered more profitable because when FDI inflow involves technology, expertise, technical skills, advanced production techniques, organizational experience, market information, product updates, and local workers are trained in new skills (Konstandina and Gachino, 2020).

According to Hussain (2021), the purpose of FDI is to advance the economy in a country with the help of long-term foreign capital. Meanwhile, for investors, the main objective of FDI is to maximize wealth by maximizing the rate of return. Yusuf and Mohd (2021) argue that the advantage of foreign investment is that it can encourage a country's economic growth without incurring foreign debt or repayment responsibilities. According to Ardiyono and Patunru (2022), FDI is decided by considering the marginal cost and its marginal return. Qiu et al. (2020) stated that apart from the rate of return, the decision to invest in a project is also seen from the amount of risk faced. Suhendra et al. (2020) stated that the size of inflows foreign direct investment to a country is influenced by the size of the multinational company's output and market size as measured by GDP. When compared with the form of capital, FDI is a long-term capital flow that does not easily cause economic turmoil (Kurniati, 2007). The four benefits of foreign investment are to fill the shortage of savings that can be collected domestically, increase foreign exchange reserves, increase government revenue, and develop economic management skills in the recipient country (Todaro: 2000).

There are some factors that attract FDI to a country, including the level of return on investment to be earned, interest rates, the political situation, profits to be earned by companies, the level of national income and its changes, technological advances and

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facilities provided by the government (Didu et al., 2022). The size of capital flows in each country also varies, depending on whether the country is a developed country or a developing country. When compared to developing countries, developed countries require a relatively limited flow of money to carry out their economic policies. The ASEAN region is one of the leading regions in Southeast Asia in terms of globalization, with the majority of its members being developing countries (Brunei Darussalam, the Philippines, Indonesia, Cambodia, Laos, Malaysia, Myanmar, Thailand, and Vietnam) and one member being a developed country (Singapore). These countries are still working to increase their economic openness. The ASEAN region is also famous for its increased industrialization sector, which can attract foreign countries to invest or trade internationally in ASEAN.

Globalization in the economy is a factor that causes the economic openness of each country to have an impact on increasing international capital flows, international trade activities, and foreign direct investment (Latif et al., 2018). The efforts of ASEAN countries to implement their openness include foreign direct investment as a supporting aspect in increasing their country's economic development. There are many similarities that ASEAN member countries have, including that abundant natural resources can be used as a source of livelihood for the population and also their geographical location. The Philippines, Indonesia, Malaysia, Thailand, and Vietnam are sources for this research, as these developing countries have the highest levels of FDI in the Southeast Asian region. The following is a graph of the development of FDI in five ASEAN countries:

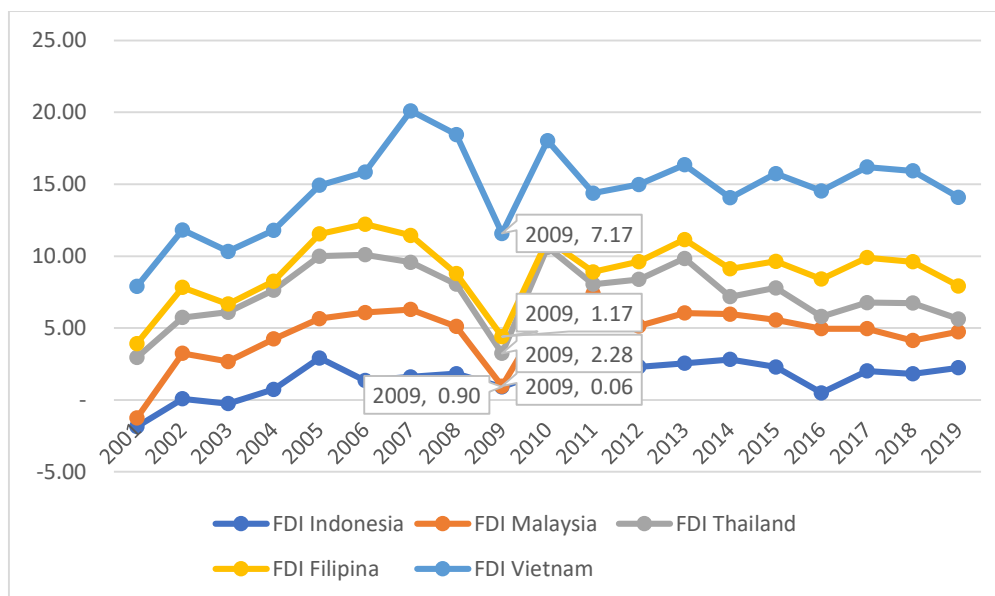


Figure 1: Foreign Direct Investment in ASEAN-5 Countries

Based on figure 1.1, Foreign Direct Investment has continued to fluctuate in each country for the last nineteen years. However, in 2009 the development of FDI in five ASEAN countries experienced a decline. Indonesia experienced a decrease in FDI of 0.90 percent, then Malaysia experienced a decrease in FDI of 0.06 percent, then Thailand experienced a decrease in FDI of 2.28 percent, then the Philippines experienced a decrease in FDI of 0.1.17 percent, and Vietnam experienced a decrease in FDI of 7.17 percent. The decline in FDI in 2009 was caused by the global economic crisis. This is the result of the financial crisis in the United States which began with the inability of France, related to the subprime mortgage from the US, to liquidate securities. This then spread to other parts of the world and became the worst liquidity crisis. However, the impact of the global economic crisis is not so severe on economic growth in Indonesia. Compared to the other five ASEAN countries, Malaysia and Indonesia had the least decline in FDI. This is because Malaysia and Indonesia have experienced dealing with economic crises in approximately ten years, so they have anticipated and prepared for them by building infrastructure and markets in their respective countries and regions outside the United States.

FDI is long term capital flow, which is expected to support sustainable investment growth in a country. For this reason, it is important to understand the factors that influence foreign direct investment in a country so that policies developed can encourage FDI growth and are oriented towards elements that play a role in persuading foreign investors to invest in FDI. Many previous studies examined the effect of corruption on a country's Foreign Direct Investment. Foreign investors will be interested in investing if Southeast Asian governments are more serious in dealing with corruption problems. As it is known that ASEAN countries have a number of low CPI scores, even though they have legal instruments to fight corruption, their enforcement is still weak. Corruption has been considered as one of the main diseases that can threaten a country's economic growth.

Transparency International defines corruption as the misuse of authority for one's own benefit. Corruption can affect investor confidence in the country's investment. According to Karim et al. (2019), an increase in perceptions of corruption will result in a decrease in the ratio between foreign investment and GDP. One tool to measure corruption is the Corruption Perceptions Index.

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Lambsdorf (1999) introduced the Corruption Perceptions Index from Transparency International (TI) in 1995 with a value of 0-100. A country with a score of 0 is a country with the highest level of perception of corrupt activity, while a country with a score of 100 is a country with the lowest level of perception of corrupt activity or can be called corruption-free. The CPI score can reflect international financial institutions and the views of multinational entrepreneurs regarding a country's institutions, bureaucracy and legal certainty, these views can influence investment decision-making in that country. Based on the results of research conducted by Transparency International in 2019, there are still many countries that show strong corruption, especially in developing countries such as Southeast Asian countries. This can be seen from the ranking of the Corruption Perceptions Index in 5 ASEAN countries as shown in the table. 1.1 featured in 2019.

Table 1.1 Corruption Perception Index in ASEAN-5

No.	Country	Rank in 2019
1	Malaysia	51
2	Indonesia	85
3	Vietnam	96
4	Thailand	101
5	Filipina	113

Source: Transparency Internasional, 2021.

Based on Table 1.1, the ranking of the Corruption Perceptions Index in 5 ASEAN Countries in 2019, explains that the country that has the highest rating of the 5 ASEAN countries is Malaysia with the 51st rank, which means that the country is a country that is safe and clean from acts of corruption. Then there is Indonesia with the 85th rank, Vietnam with the 96th rank, and Thailand with the 101st rank, in each of these countries the CPI level can be used to describe legal certainty and corruption. The country that has the lowest ranking of the 5 ASEAN countries, namely the Philippines, is ranked 113th, which means that the Philippines has a high level of corruption and is vulnerable to such actions.

There are two opinions in the study of the effect of the Corruption Perceptions Index on Foreign Direct Investment, namely that there is a significant positive effect, meaning that when the level of corruption decreases, foreign direct investment will increase, because investors believe that countries with lower levels of corruption show good bureaucratic quality, this is according to the study by Epaprha & Massawe (2017). However, this study is not supported by the studies of Bukhari et al. (2020) has a negative impact of CPI on FDI, this is because a high level of corruption in a country can increase investment risk thereby reducing foreign direct investment funds.

2. LITERATURE REVIEW

This study investigates the effect of CPI and some economic variables, such GDP growth exchange and interest rate on the FDI inflow in ASEAN-5 countries. The effect of CPI on FDI has been studied by Epaprha and Massawe (2017), Karim et al. (2018), Fazira & Cahyadin (2018), Bukhari et al. (2020), and NGO et al. (2020). Epaprha and Massawe (2017) examined the effect of corruption on FDI and found that CPI, GDP per capita, rule of law, political stability, government effectiveness, corruption control, and trade openness has a positive effect, while other variables have a negative effect on FDI. Karim et al. (2018) investigate the effect of corruption on FDI in ASEAN-5 and concluded that CPI has a positive significant effect on FDI.

Fazira & Cahyadin (2018) analysed the impact corruption Perception Index, and Economic Growth on Foreign Direct Investment in ASEAN-6 and concluded that interest rates and GDP had a positive effect, while the CPI had a negative effect on FDI. Bukhari et al. (2020) investigated the effect of corruption on FDI and found that CPI has a positive effect in the long term and in the short term on FDI. NGO et al. (2020) analysed the determinants of Foreign Direct Investment in Vietnam. They concluded that GDP, labor force, skilled workforce, macroeconomic policy & CPI have a positive effect on FDI. Meanwhile, trade openness and infrastructure have a negative effect on FDI.

Prior empirical research investigated the association between FDI and economic growth, such as Anwar (2023), Sengupta and Puri (2020), Jaiblai and Shenai (2019), Sabir et al. (2019), Sayari et al. (2018), Rashid et al. (2017). Rashid et al. (2017) discovered that from 2000 to 2013, FDI inflow in 15 countries was positively impacted by GDP. Similarly, Sayari et al. (2018) found a positive association between GDP growth and FDI in Central and Eastern Europe. Conversely, Sabir et al. (2019) discovered that from 1996 to 2016, the GDP of 39 developing and 44 advanced nations had a negative impact on FDI. As stated by Jaiblai and Shenai (2019), from 2003 to 2017, GDP increased FDI in 10 Sub-Saharan economies. Additionally, Sengupta and Puri (2020) demonstrated a favourable correlation between GDP and FDI in South Asian nations. Anwar et al. (2023) found that economic growth has a positive and significant effect on FDI.

The influence of interest rate on FDI was analyzed by Suhendra et al. (2022), Awad (2020), Islam and Sahajjalal (2019), Albulescu and Ionescu (2018), Hossain and Ahmed (2018), and Musyoka and Ocharo (2018). Musyoka and Ocharo (2018) found a

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negative relationship between interest rate and FDI in Kenya. Also, Hossain and Ahmed (2018) showed that interest rate has an insignificant negative influence on FDI in Bangladesh. Albulescu and Ionescu (2018) found a negative association between interest rate and investment for 16 EU countries. Furthermore, Awad (2020) showed a negative impact of interest rate on investment in Malaysia. Suhendra et al. (2022) found that interest rate has a negative effect on investment.

Chan et al. (2013) examined the influence of GDP, Local Investment, and Telecommunication on FDI. The results showed that GDP, Local Investment, and Telecommunication have a positive and significant influence on FDI. Furthermore, Sofilda et al. (2015) investigated the determinant factor of FDI in ASEAN-5 Countries from 2004 to 2012. Their result showed that GDP and trade openness positively and significantly affect FDI, while interest and exchange rates have a negative impact. This is in line with Karno (2014), which showed that interest rates have a negative and significant effect on FDI. Petrović-Randelović (2017) examined the influence of GDP growth and per capita, trade openness, interest rate, and total population on FDI using the panel data estimation. The results showed that GDP growth and per capita, interest rate, and total population positively and significantly affect FDI, while trade openness has a negative and significant effect. Moreover, Kumari and Sharma (2017) examined the influence of human capital, trade openness, and infrastructure on FDI using the Panel method. Results showed that human capital and trade openness positively influence FDI, while infrastructure has a negative influence. Karima et al. (2018) studied FDI in Southeast Asia using the panel data method and found that GDP and inflation have a positive but insignificant effect on FDI.

3. DATA AND METHODOLOGY

3.1. Data

This study used a panel data methodology with fixed effect estimation in 5 ASEAN countries, including Indonesia, Singapore, Malaysia, Thailand, the Philippines, and Vietnam from 2004 to 2019. The inflow of foreign direct investment into the host nation is known as FDI. The study made use of a few major FDI-influencing control factors, such interest rate, and economic growth.

3.2. Econometrics Methodology

The impact of CPI on FDI was examined using panel data and fixed effect estimates. The classical assumption and other required checks were also carried out in the equation of the research model. This study examines the association between CPI and FDI based on the Epaphra and Massawe (2017), Fariza and Cahyadi (2018), Karim et al. (2019), Bukhari et al., (2020). In Eq (6) was extended by adding control variable. According to Anwar et al. (2023), the economic growth is one of the main determinants of FDI. Additionally, model four added the interest rate because it is one of the requirements for investment. According to Suhendra (202), interest rates and foreign direct investment are associated negatively.

$$FDI_{it} = \beta_0 + \beta_1 CPI_{it} + \beta_2 EG_{it} + \beta_3 IR_{it} + \varepsilon_{it} \quad (1)$$

Where FDI is foreign direct investment as a dependent variable; CPI is corruption perception index; EG is economic growth; IR is the interest rate, and ε is error disturbance.

4. EMPIRICAL RESULTS

4.1 Descriptive Statistics

Table 1: Descriptive Statistic

Variable	Mean	Std Dev.	Min.	Max.
FDI	2.9159	1.9908	- 0.2500	9.600
CPI	0.3427	0.0894	0.1900	0.5300
EG	5.2173	1.9317	-1.5100	7.5500
IR	3.3539	3.3981	3.500	11.00

Source: Authors' statistical results.

The descriptive statistic for the variables is displayed in Table 1. Data from 2001 to 2019 revealed that FDI growth ranged from - 0.25% to 9.6%, on average, with a low of 2.9159% and a maximum of 9.6%. In addition, the ASEAN-5 nations' average CPI, which stands at 0.3427, is rather low. However, some nations attain a CPI of 0.53 as their maximum and 0.19 as their minimum. The largest rate of economic growth was 7.55%, with an average growth rate of 5.2173% for the ASEAN-5 nations. The smallest amount of economic growth, however, was -1.51%. Additionally, there was a minimum interest rate of 3.5% and a maximum interest rate of 11%.

4.2 Classical Assumption Tests

Classical hypothesis and normalcy tests were run to assess the accuracy of the data. The Multicollinearity, Heteroscedasticity, and Autocorrelation tests make up the traditional assumption test. To determine whether our data have a multicollinearity issue, Table 2 provides a correlation matrix.

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Table 2: The Result of Multicollinearity Test

	CPI	GDP	IR
CPI	1	-0.1264	-0.0875
EG	-0.1264	1	-0.2942
IR	-0.0875	-0.2942	1

Source: Authors' statistical results.

The table 2 findings of the multicollinearity test employing a correlation matrix show that there is less than a 0.80 correlation between the independent variables. It is clear that the independent variables do not relate to one another linearly. Therefore, our data do not have a multicollinearity issue.

Table 3: Classical Tests

Num.	Testing	Value	Conclusion
1.	Heteroscedasticity		
	No. Obs	90	$\chi^2_{count} < \chi^2_{90;0.05}$ no heteroscedasticity
	R ²	0.7025	
	X ²	63.2217	
X ² table	108.6479		
2.	Autocorrelation (DW test)		
	DW count	1.9515	$D_U < 1.9515 < 4 - D_U$ no autocorrelation
	D _L	1.4149	
	D _U	1.7264	
	4-D _U	2.2736	
4-D _L	2.5851		
3.	Normality		
	JB	1.4065	normally distributed
	Probability	0.4149	

Source: Authors' statistical results.

Table 3 displays the outcomes of the White test, which looks for the presence of the heteroscedasticity problem, the Durbin-Watson test, which looks for the presence of the autocorrelation problem, and the Jarque-Bera test, which looks for the presence of a normally distributed residual in our data. We draw the conclusion that the study's data are homoskedastic and autocorrelation-free, and that the data's residuals have a normal distribution.

4.3 The Fixed Effect Model Result

Table 4: Fixed Effect Estimation

Variable	FDI
CPI	8.0547*** (2.6952)
EG	0.2200*** (0.0804)
IR	-0.0892** (0.0411)
C	-0.6936 (0.9419)
R ²	0.7926

The symbol * denotes statistical significance at the 1% level.

The outcomes of fixed effect estimate for is shown in Table 4. With a significance threshold of 1%, the impacts of CPI and economic growth on FDI are both favourable and substantial. However, interest rates have a negative and considerable impact on foreign direct investment. The R-square is 0.7926 according to the results of the coefficient determination test. This demonstrates that about 80% of the changes in foreign direct investment are explained by explanatory factors, whereas the remaining 20% is explained by fluctuations not included in the model.

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4.4 Discussion

The corruption perception index has a positive and significant influence on Foreign Direct Investment, this is evidenced by the statistical results ($2.143178 > t_{table} (1.987934)$) with a Prob value. $0.0351 < \alpha = 0.05$. With a coefficient value of 4.914277, it means that if there is an increase in the corruption perception index by 1%, it will lead to an increase in foreign direct investment in ASEAN-5 by 4.91% and vice versa. These results are in line with the signalling theory (Akerlof, 1970), the corruption perception index can provide instructions to investors about distinguishing between high-value companies and low-value companies. Because the CPI is one of the economic variables that can affect the inflow of foreign direct investment funds in ASEAN-5. The higher CPI index, the greater FDI inflow to a country. The higher the CPI index, the lower the level of corruption in the country. This means that the smaller the risk taken by foreign investors, the increased quality of the bureaucracy has a positive impact on FDI (Karim, 2019). These results are also in accordance with the previous study by Epaprha and Massawe (2017), Karim et al. (2018), Fazira & Cahyadin (2018), Bukhari et al. (2020), and NGO et al. (2020) who found that CPI has a significant positive effect on FDI. This means that a reduced level of corruption will have an impact on improving the quality of the government bureaucracy which will in turn influence policies that can benefit investors themselves. However, this study is not supported by the study of Bukhari et al. (2020) which shows that the IPK has a negative and insignificant effect on FDI. The selection of the number of samples, the object of research, as well as the analytical techniques used to differentiate these results from other studies.

Gross Domestic Product has a positive and significant influence on Foreign Direct Investment, this is evidenced by the results statistic ($3.960610 > t_{table} (1.987934)$) with a Prob. $0.0002 < \alpha = 0.05$. With a coefficient value of 0.198401, it means that if there is an increase in gross domestic product by 1%, it will lead to an increase in foreign direct investment in ASEAN-5 by 0.19% and vice versa. These results are in line with the classical theory of economic growth (Lowe, 1954), the higher the level of national income can affect the income of the people, so that the demand for goods and services will increase. In this way the company's profit can be increased and it will also have an impact on increasing investment. These results are supported by the research conducted by Anwar et al. (2023), their research shows that GDP has a significant positive effect on FDI. If GDP increases, FDI will also increase. An increase in GDP shows an improvement in a country's economy that can influence investors in investing. This research is also strengthened by the research of Rashid et al. (2017), Sayari et al. (2018), Sabir et al. (2019), Jaiblai and Shenai (2019), and Sengupta and Puri (2020), concluded that GDP has a significant positive effect on FDI.

Interest rates have a negative and significant effect on Foreign Direct Investment, this is evidenced by the results if the statistic ($-3.437615 > t_{table} (-1.987934)$) with a Prob. $0.0009 < \alpha = 0.05$. With a coefficient value of -0.084490, this means that if there is an increase in interest rates by 1% it will cause a decrease in foreign direct investment in ASEAN-5 by 0.08% and vice versa. These results are in line with the endogenous growth theory developed by Romer (1994) which states that investment is a function of interest rates. If interest rates increase, the desire to invest will decrease. Because investors are reluctant to invest in countries with higher interest rates than the returns generated in investment destination countries. In addition, if interest rates decrease, the desire of investors to invest will increase. This is due to the fact that countries with low interest rates or below the rate of return are preferred by investors because from this they can get profits. These results are in accordance with the study of Suhendra et al. (2022), their research shows that interest rates have a negative and insignificant impact on FDI. The results of this study are in accordance with the theoretical concepts in this study. Because interest rates are higher, the amount of FDI entering ASEAN-5 will decrease, and vice versa. This study is supported by the study of Musyoka and Ocharo (2018), Hossain and Ahmed (2018), Albulescu and Ionescu (2018), Islam and Sahajalal (2019), Awad (2020), and and Suhendra et al. (2022) who found a negative effect of interest rate on FDI.

5 CONCLUSION AND RECOMMENDATION

This study analyzed the relationship between CPI and FDI inflow in ASEAN-5 countries. It used the panel data regression model with fixed effect estimation to show the connection between those variables. In line with Bukhari et al. (2020), this study showed that high CPI results in increased FDI inflow to developing countries, especially the ASEAN-5 countries. Furthermore, the study used some control variables, such as economic growth and interest rates to find the relationship between CPI and FDI. Empirical findings show a positive effect of CPI on FDI, which supports Bukhari et al. (2020), Furthermore, economic growth on FDI, which supports Anwar et al. (2023), This study supports Suhendra et al. (2022) which found a negative relationship between interest rate and FDI. This study recommends that policymakers must pay more attention to the factors influencing FDI inflows. Moreover, the government needs to increase the CPI and economic growth to attract more FDI inflow and stabilize monetary policy.

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