FACTORS DETERMINED FOREIGN DIRECT INVESTMENTIN ASEAN-5; PANEL DATA ANALYSIS, 2000-2012

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Abstract— The number of *Foreign Direct Investment*(FDI) in Asia, especially in ASEAN countries has been increasing drastically over the past few decades. FDI is one of the sources of investment that is really important, mainly for developing countries.

This research aims to investigate what factors that determine FDI in ASEAN, during 2000-2012. ASEAN-5 (Indonesia, Singapore, Thailand, Malaysia and Filipina) are the object of this research.By using panel data analysis and STATA 11 as the software, it is seen that generally, factors determine FDI in ASEAN are growth rate of GDP, interest rate, inflation rate, and *trade openness*. For Indonesia, FDI is influenced by the growth of GDP and inflation rate. The growth of GDP also affects FDI in Singapore, together with interest rate, *trade openness*, and depreciation rate of SGD, while, inflation rate and *trade openness*affect FDI in Thailand. In Malaysia, FDI is affected by the growth of GDP, inflation rate, and also *trade openness*, and only inflation rate that influence FDI in Filipina.

Keywords— FDI, ASEAN, Trade openness, Depreciation Rate, Growth of GDP, Inflation Rate, Interest Rate, Panel Data, STATA 11.

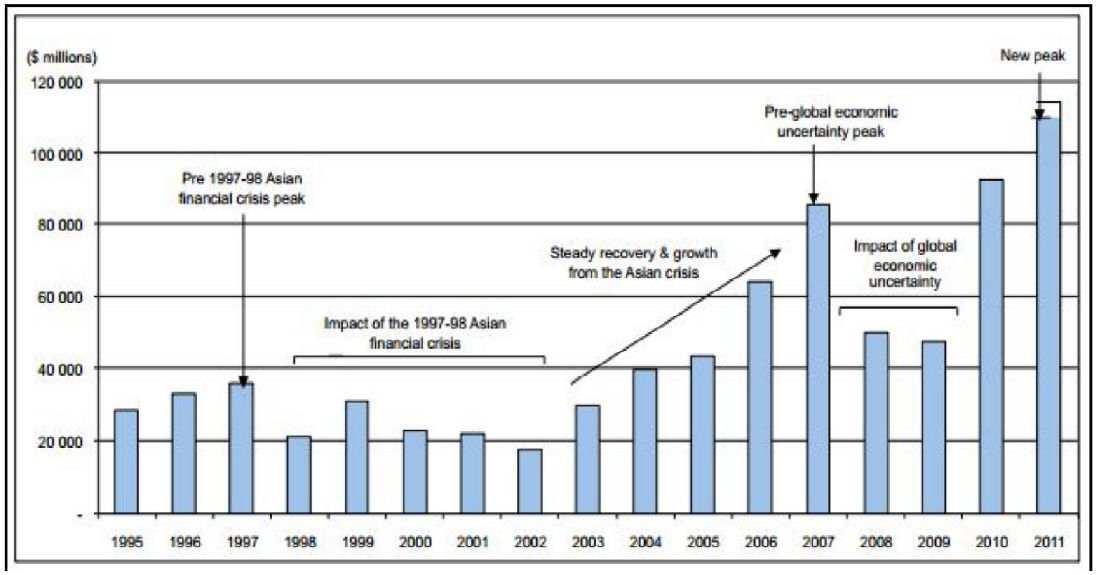
I. BACKGROUND

The flow of Foreign Direct Investment (FDI) to the emerging Asian countries has been increasing rapidly since the early 1990s. Despite a decline when the Asian crisis in the late 1990, FDI flows into these countries has again increased rapidly after the crisis.

Since its inception in 1967, ASEAN (Association of South East Asian Nations) has been transformed from a developing country into a group of ten countries considered in the global arena. With its strategic location, abundant natural resources, high quality of human resources, and resistant economics to crisis, ASEAN has been involved in the economic, trade and investment with all the major economies of the world. This can be seen by the fact that there are 55 countries worldwide that have been cooperating with ASEAN (Economic Research Institte for ASEAN and East Asia, 2012).

In terms of investment levels, ASEAN region has become a great area for investment destination. Based on the World Investment Report 2013, published by UNCTAD, four ASEAN countries, namely Vietnam, Indonesia, Thailand, and Malaysia are included in the 20 countries that became top host economies for FDI during 2010 to 2012. In fact, a survey conducted by UNCTAD to the company- transnational companies (TNCs company / TNC), during 2013 to 2015, ASEAN countries still belong to the priority countries targeted for the host country for FDI.

Figure 1
Progress ofFDI in ASEAN



Source: ASEAN Secretariat, ASEAN FDI Database and UNCTAD FDI Database

As a form of capital flows that are long-term and relatively vulnerable to economic turmoil, Foreign Direct Investment (FDI) is expected to help encouraging the growth of a sustainable investment in a country. FDI is also preferred over portfolio investment. Therefore, it becomes important to know the determinants of FDI in a country so that it can formulate a policy to promote FDI flows to become more effective and directed to factors that are important and influential to encourage foreign investors to invest in the form of FDI.

In line with the implementation of the ASEAN Economics Community (AEC) in 2015, the policy in the field of investment becomes crucial. For this reason, the more important research on FDI ASEAN countries, especially the factors that influence it, so that the ASEAN region will increasingly be able to attract FDI, both FDI of the ASEAN countries (intra ASEAN) as well as FDI from partner countries. By knowing the factors that affect FDI, it can be formulated investment policy continues to be relevant and effective to support the sustainability and growth of investment inflow into ASEAN. The ability to attract FDI is also ultimately will further strengthen the position of ASEAN in the international economic arena and also improve the economics of its member (Towle, 2012). This paper mainly discuss about the

"Determinants of Foreign Direct Investment in ASEAN-7: Panel Data Analysis, 2000-2012".

II. THEORITICAL BACKGROUND

2.1 Foreign Direct Investment

Krugman in I Made Yogatama Mudara Pande (2011) states that the definition of foreign direct investment is the international capital flows where an enterprise of a country establishing or expanding a company in another country. A prominent feature of foreign direct investment is to involve not only the transfer of resources but also the implementation of control. So, branches or subsidiaries not only have financial obligations to the parent company; he was part of the same organizational structure (Mudara; 2011). The classification of direct investments into a separate investment type is based on an emphasis on differences in motivation in making investments, in the direct investment, investors hope to gain benefit from the right to vote in the company's management.
Investment in Indonesia is regulated under the Law No. 25 of 2007 on Investment. In this Act, Foreign Investment is investment activity to conduct business in the territory of the Republic of Indonesia, made by a foreign investor, either using foreign capital or joint venture with a domestic investor (Article 1 of Law No. 25 2007 on Investment).

According to Hirsch, in Hasbullah 2009, foreign direct investment will be chosen when earnings are expected to be greater than the costs required to conduct surveillance abroad. Or the costs of production and control abroad is lower than the costs of domestic production plus the costs of marketing exports.

Alan M. Rugman stated that Foreign Direct Investment (FDI) is influenced by environmental variables and variable internalization (Rosyadah, 2011).

In the literature on the theory of Multinational Enterprises, the environment variable is often referred to as the specific advantages of the State (KSN) or a specific factor (location). KSN is a variable that affects the nation as a whole.

There are three types of environment variables of concern, namely: economic, non-economic, and government.

Hymer is considered as the pioneer in the theory of foreign investment. Hymer, in Midonal (2011), suggests an approach that emphasizes the role of industrial organization excellence and imperfections typical enterprise market in an effort to explain the motivation underlying the company in making an investment. FDI is a direct effect of the market is not perfect. This theory is carried out by placing several stages of production at several different locations around the world. The goal is to get the advantage of low production costs, the benefits of local tax policies more favorable or anything else.

According to this approach, a higher return on investment abroad does not guarantee the completeness explanation of capital flows. Because the return on the investment itself mean that the capital will be more efficient when allocated through the capital market and does not require removal of the company.
Under the direction of capital flows, foreign direct investment is divided into inward FDI and outward FDI.

2.2 Determinant Factors of FDI

2.2.1 Market Size

Market size can be defined as the number of buyers (and sellers) that are deemed as potential in a market. According to Resmini, 1999, market size is often proxied by population, economic growth, or national income (GDP and GDP per capita). The magnitude of the economic growth of a country each year is one indicator of economic measurement that in the long run will be more attractive foreign direct investment (Kesit Bambang, 2003).

2.2.2 Inflation

Inflation also affects foreign direct investment. High inflation makes prices of goods and services become

expensive so that the cost of production inputs will also be increasing. This condition causes the businesses have to increase the price of output that can lead to low competitiveness. Inflation also resulted in people's purchasing power. It will decrease the people's purchasing power, that the demand for goods and services will be declined, resulting in sluggish trading activity and investor difficult to get a return and profit.

On the other hand, the inflation rate reflects the macroeconomic stability of a country. The more stable macroeconomic conditions of a country, it can reduce investment uncertainty and increase investor confidence.

It is also said by Mishkin (2001), that the inflation rate can affect indirectly on investment. When there is inflation, prices will rise, including the factors of production. When the prices of factors of production increases, the company tends to reduce investment, which in turn causes the investment will decline.

2.2.3 Interest Rate

According to the experts of classical economists, the relationship between interest rates and investment is negative. The higher the interest rate, the willingness to invest will be smaller. It can also be seen through the curves of Marginal Efficiency of Investment, which explains that the investment will be made by the investor if the rate of return on capital is greater or at least equal to the interest rate.

The interest rate can also be used to reflect the cost of capital required by investors when they want to use / borrow funds from banking institutions in the host country. Low interest rates may encourage investors to increase their capital spend to finance their investment activity. The negative relationship between the interest rate and foreign investment is also confirmed by previous studies, such as byLubis (2010), which indicates there is a negative and significant influence between domestic interest rates with foreign direct investment in Indonesia.

2.2.4 The Depreciation Rate of Exchange Rate

With the development of the international economy is rapidly increasing, the economic relations between countries become intertwined and lead to the increasing of trade flows of goods, money and capital between countries. Changes in a country's macroeconomic indicators, will certainly have an impact on other countries. One indicator of macro influence vulnerable is the exchange rate (Wibowo, 2005).

In relation to FDI, the exchange rate can affect the total amount of foreign capital into the country, as well as the allocation of the Foreign Direct Investment (Goldberg, 2009). When a country's exchange rate depreciates (increase of the nominal value or, in other words is impaired compared with the country's currency), it will be a positive influence on foreign direct investment in the country. This is because when the exchange rate of a country depreciates, the amount of wages of workers and also the cost of production in the country will decline to foreign investors, thereby increasing the attractiveness for foreign investors to invest. In addition, exchange rate depreciation also increases the potential to increase the export of goods, which can attract investors.

2.2.5 *Trade openness*

In globalization era, economic openness issomething that is inevitable. The openness itself can be form in openness in foreign trade (trade openness) and openness in the financial sector (financial openness).Trade openness can be describedas the losing barriers in trading, both in the form of tariff and non-tariff, and the smooth mobility of capital between countries. Theoretically, economic openness provides benefits for all countries who involved in it.

Although the value of trade openness is often associated with the notion that the economy is tend to be more vulnerable, by losing access to foreign financing (Agenor, October 2001), but a decrease in the level of restrictions imposed on trade when a country increase trade openness is also likely to increase FDI horizontal in the host country.Hoang (2012) also stated that thehigherthe trade openness, the easier it is for foreign investors to exploit the comparative advantages of the host country to be able to reexport.

2.3 *Push Factors* dan*Pull Factors*

Sitinjak, 2011 declares that the decision of foreign investors to invest in an investment destination is generally affected by the conditions of the investment destination country (pull factors) and also the conditions and strategies of foreign investor countries (push factors).

Pull factors which affect the inflow of foreign investments consist ofthe confition in destination market, the availability of existing resources, competitiveness, government policies related to trade and industry and also government policy related to foreign investment.

Push factors which affect foreign investments can be concluded to: the production strategy of the company which will carry out foreign investment, as well as the risk perception of foreign investors in the destination market.

2.4 Framework and Hypothesis

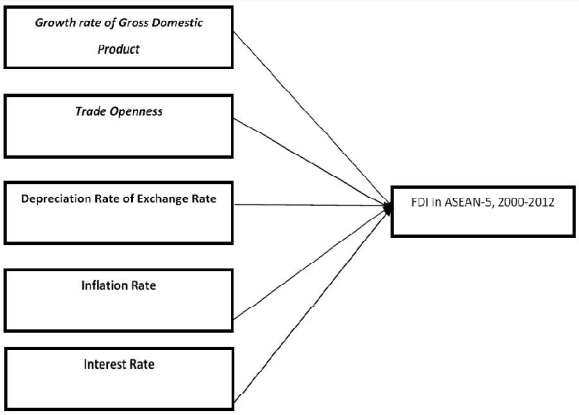


Figure2: Model Framework
Kerangka Model

Hipotesis Penelitian
Hypotheses:

H1 :GDP growth has positive effect on Foreign Direct Investment.
H2 : *Trade openness*has positive effect on Foreign Direct Investment.
H3 : Depreciation rate of exchange rate has positive effect on Foreign Direct Investment.
H4 : Interest rate has negative effect on Foreign Direct Investment.
H5 : Inflation rate has negative effect on Foreign Direct Investment.

III. METHODOLOGY

This study uses a quantitative approach to analyze the factors that affect the amount of Foreign Direct Investment in the fifth ASEAN countries. In doing this quantitative analysis, econometric tool; panel data analysis is used. It is because this researchcombined time series and cross section data. Type of panel data used in this study is a balanced panel, where each unit cross section has a number of observation time series of the same.

3.1 Variables and Its Measurement

There are two type of variables; namely independent variable (Foreign Direct Investment) and dependent variable. The dependent variables consist of inflation rate, market size, interest rate, trade openness, and depreciation rate of exchange rate.

Table 1: Variables

Variabel	Explanation	Scale
Independent	Interest rate	Ratio
	Inflation rate	Ratio
	GDP Growth	Ratio
	Trade Openness	Ratio
	Depreciation rate of exchange rate	Ratio
Dependent	FDI	Ratio

1. Inflasi rate is measured by using the Cunsumer price Index (CPI) and stated in percent (%).
2. Interest rate is measured by the lending interest rate) that is used by each country and also stated in percent (%)
3. GDP Growth is the increasing of each country's GDP, and stated in percent (%).
4. While there are several ways to measure trade openness, in this research we proxied trade openness as the sum of goods and services that exported (in US$) and also imported (in US$), and divided by real GDP (in US$). This variable is stated in percent (%).
5. The depreciation rate of exchange rate represents the difference between the currency exchange rate of the origin of the fifth countries as compared with the United States (US $) in the current year minus the previous year and divided by the exchange rate in the previous year. This is stated in %.
6. FDI is proxied as the percentage of GDP.

The data used is a secondary data from the World Bank, the International Monetary Fund (IMF), and the Asian Development Bank (ADB)`

3.5 Model

The design of the model that will be proposed is a linear regression model with five independent variables, with the following model:

$$FDI = ß0 - ß1\ INFLATION - ß2\ INTEREST + ß3\ GDPG + ß4\ OPENNESS + ß5\ DEPRESIASI + e$$

e = *residual/error*

3.6. Tool Analysis

The analytical tool used in this research is usingpaneldata analysisand also using STATA as the tools. Panel data model that can be generated is a common effect, Fixed Effects and Random Effects.

3.6.1 Stationarity Test

Before estimating panel models, the first step to do is to test the stationarity for each variable. Stationarity test is done to avoid spurious regression (spurious regression).

In this study, the test was conducted Levin-Lin-Chu stationarity test to see kestasioneritasan overall variables (common unit root) and also Im-Pesaran-Shin stationarity test to see the condition of the individual variables (individual unit root).

The hypothesis proposed:

Ho: variables are not stationary.
Ha: stationary variable.
Ha will be rejected if the value of Prob. > Alpha (0:05) and the statistical value of the variable is positive.

3.6.2 Chow Test

Chow test is conducted to choose between Pooled Least Squared and Fixed Effect models. The hypothesis is:

Ho: models Pooled Least Squared (PLS) is better.

Ha: Fixed Effectis better.

If the result of Prob. > F is smaller than the value of α (5 percent), then Ho will be rejected and Ha accepted. In other words, the better the model Fixed Effect. Vice versa, if the results of Prob. <F greater than the value α, so Ho accepted and Ha rejected.

3.6.3 LM Test

This test is conducted to choose between Pooled Least SquaredorRandom Effect. Hypothesisproposed is:

Ho: Pooled Least Squared model is better

Ha: Random Effect model is better

If the result of Prob. <A (0:05), then Ho will be rejected, and vice versa.

3.6.4 Hausman Test

Hausman test is used to determine the best model among Fixed Effects Model and Random Effects Model. The hypothesis is as follows:

Ho: Random Effect model is better

Ha: Fixed Effect model is better

If the Probability of Chi-square> 0.05 then Ho is accepted models used Random Effect. But if Probability <0.05, the model used is the Fixed Effect.

3.7 Model Evaluation Method

Estimation methods produced through the panel data analysis methods should be evaluated based on the following criteria: T-Test, F-Test and also Goodness of Fit Test.

IV. RESULT ANALYSIS

4.1 Result

4.7.1 Stationarity Test

Results and discussion in this study will be based on the steps that have been described previously. The first step in conducting an econometric analysis to analyze the time series data is to do a test to see variable stationary stationary or not..

Stationarity test used is Levin-Lin-Chu test and Im-Pesaran-Shin. Based on test results obtained, shows that all variables are stationary at a level so that the level of the test data is continued and there is no change in the data used models.

4.7.2 ChowTest and Hausman Test

Hausman test results shows that the chosen model Fixed Effect better. This is because the value prob> chi2 produced less than 0.05, that is equal to 0.0190. Thus, in this study, panel data model used is the Fixed Effect.

4.7.3 Estimation Result

Table 5: Estimation Result in ASEAN-5

Dependent Variable: *Foreign Direct Investment*			
Variable	**Effect Expected**	**Coefficient**	***p-value/2***
GDP Growth	+	0.456641	0.0015
Depreciation Rate	+	0.001308	0.4320
Interest Rate	-	-0.413510	0.0165
Inflation Rate	-	-0.124592	0.0975
Trade openness	+	0.00031	0.008
C	+	4.836375	0.000
Prob. *F-Stat*	0.0000		
Adjusted R^2	0.4770		

Sumber: Data diolah, STATA 11

Table 5 indicates that the amount of FDI in fifth ASEAN countries significantly affected by trade openness, GDP growth, interest rates, and inflation rates together. This is reflected in the value of Prob. F-statistic that has significant value, amounting to 0.0000.

All variables used also has a correlation direction in accordance with the theory and hypothesis, in which the level of depreciation of the exchange rate, trade openness, and GDP growth have a positive influence on FDI, while the level of inflation and interest rates have negative influence. However, based on the significance of each of these variables, it was found that the variable rate of depreciation of the exchange rate was not statistically significant effect on the amount of FDI in ASEAN, despite having the direction of correlation in accordance with the theory and hypothesis.

Constant value indicates the value of the dependent variable when there is no influence of the independent variables used. Based on the results of data processing, it was found that the magnitude of ASEAN FDI will amounted to 4.836375% of GDP level when there is no influence of the independent variables.

The value of Adjusted R-Squared of 0.4770 indicates that all independent variables that are used (depreciation rate, interest rates, inflation, trade openness, and GDP growth) are able to explain the behavior of the dependent variable (FDI) amounted to 47.70%, while the remainder, amounting to 52.3% of the behavior of the dependent variable explained by other variables that are not used in the model. These factors may consist of the level of infrastructure, availability and productivity of labor, political

stability, and also the consumptive nature of the society of a country.

Overall, in terms of infrastructure provision, ASEAN also experienced other obstacles such as gaps infrastructure between the ASEAN countries, in the sense that the level of development and infrastructure provision between the ASEAN countries is quite different drastically with other countries. The existence of infrastructure in the ASEAN region is still lower when compared to some other regions of the world, among others, with Asia, Latin America, and Africa (based on records of Proceedings of High Level Task Force on ASEAN Infrastructure Fund VI, Jakarta, 2011). However, in the last three years, all ASEAN countries have agreed to consider and prioritize the improvement of infrastructure facilities, which are applied through some cooperation in the field of infrastructure, such as the ASEAN Infrastructure Fund (AIF). The application of this AIF itself was rated by many ways that also increase foreign investment because ASEAN is also working with foreign investors.

Beside infrastructure, labor conditions, both in the availability of labor and minimum wage policies implemented by each country have contributed to the considerations for foreign investors in investing. With the level of population reached about 650 million people (data at the end of 2013), putting ASEAN into a region with the amount of labor that much. The minimum wage rate in the ASEAN region is also quite low compared to other countries. Based on reports from the Department of Labor and Employment National Wages and Productivity Commission International Labor Organization in 2012, ASEAN countries have minimum wages are relatively low compared to other countries in Europe or America. Wages in Indonesia admittedly quite low in ASEAN, with a minimum wage of Rp2.200.000.
Based on the results, it can be concluded that while there was an increase of 1% of GDP of the seven ASEAN countries, the magnitude of ASEAN FDI flows will increase by 0.456641% of GDP level. This influence also demonstrated statistically significant. This is in line with theory and hypothesis, that the current level of GDP increases, which means an increase in market size and purchasing power, investors will see this as a profitable thing, so that they will invest in the region. Likewise, when a decline in GDP of 1%, ASEAN FDI will decrease by 0.456641% of GDP level.

Classical economists pegging interest rates as one of the factors that most influence the investor to make an investment. Based on the results of data processing, it was found that the interest rate has a negative influence on FDI ASEAN. When there is an increase in the interest rate by 1% in ASEAN, the ASEAN FDI will decrease the amount of 0.4135101% of GDP level. Likewise, when an increase in interest rates by%, the amount of FDI ASEAN will decrease by 0.4135101% of GDP level. These results are statistically proven to be significant.
Currently, when the inflation rate in ASEAN increased by 1%, then the ASEAN FDI will decrease by 0.124592% of GDP level, and vice versa. Statistically, the effect of the inflation rate is also proved significant. This is needed to be considered by the ASEAN countries. Trade openness is an exteral factors that can affect the amount of FDI. Based on the results of data processing, it was found that increasing trade openness, would increase FDI in ASEAN. When trade openness in ASEAN countries increased by 1%, then FDI will increase by 0.00031% of GDP level. Likewise, when trade openness ASEAN countries declined by 1%, will cause a decline in FDI amounting to 0.00031% of GDP level. This means that the current ASEAN countries can improve their international trade activities, the potential for increasing the FDI will be even greater.

Based on the results, it appears that the rate of depreciation of the domestic currency ASEAN countries do not have a statistically significant effect on FDI ASEAN. This is because the p-value of this ¬variabel greater than 0.05 (ie 0.4320). This may imply that the rate of depreciation of ASEAN countries is not a major factor for foreign investors to invest in ASEAN, which can be associated with a still quite fluctuative the exchange rate of each country compared to US $. These results also indicate that the variable rate of depreciation of the exchange rate is the only variable that does not have a significant effect on FDI ASEAN.

CONCLUSIONS AND RECOMMENDATION

5.1 Conclusion

ASEAN countries have agreed to put investment as a key component in the economic development of ASEAN, and make it as one of the principal objectives of ASEAN in efforts to achieve economic integration of ASEAN (AEC) in 2015.
From the analysis above, the flow of FDI in five ASEAN countries (Indonesia, Singapore, Thailand, Malaysia, and Philippines) is significantly influenced by the growth in GDP, trade openness, interest rates, and inflation rates. The whole variable also has a direction in accordance with the correlation theories and hypothesis. Among all variables, GDP growth has the greatest influence. The results of this discussion by using alpha of ten percent. And among all the independent variables are used, only the rate of exchange rate depreciation has no statistically significant effect on FDI ASEAN.

5.2 Policy Recommendation

Macroeconomic conditions in the ASEAN region also need to be protected and preserved. The rate of

economic growth should be able to be increased, because it is a determinant in attracting FDI has considerable influence. Related to GDP growth, based on the report of the ASEAN Business Club last end of 2013, there are six important sectors to be maintained stability, namely airlines, banking, capital markets, health, infrastructure, and power and utilities. Sixth this sector is a sector which is believed to support ASEAN's economic growth, so that when ASEAN is able to maintain the condition of the six sectors, the rate of economic growth in ASEAN can be increased.

5.3 Recommendation for Future Study

Due to many limitations in this paper, further studies are still needed. This research focused only on macroeconomic variables, whereas in decision making for investors to invest is certainly not only the economic factors considered; other variables, such as domestic infrastructure, labor conditions (both labor costs and quality / productivity of labor), nor political stability should also be seen as the determinant FDI in ASEAN. The number of free trade area between one country to another or between regions, that has been increasing recent years, due to the higher level needs to be seen whether globalization also be determinant for FDI, so it can be taken a step mutual support. In addition, it would be better if it can use the entire ASEAN countries in conducting data analysis.

The study also only about inward FDI. While on the other hand, research on outward FDI is also necessary..

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APPENDIX
Stationarity Test Result Data (in Level).

No.	Variable	Stationarity Method			
		Levin-Lin-Chu		Im-Pesaran-Shin	
		Statistic	*P-Value*	*Statistic*	*P-Value*
1.	FDI	-0.4022	0.0438	-1.2053	0.0141
2.	GDP Growth	-3.0338	0.0012	-2.7499	0.0030
3.	Depreciation rate of exchange rate	-0.0685	0.0117	-3.8584	0.0499
4.	Interest rate	-6.0064	0.0000	-1.3145	0.0943
5.	Inflation rate	-1.9048	0.0284	-3.4450	0.0003
6.	*Trade openness*	-1.3875	0.0126	-0.2628	0.0537

Fixed Effect Panel Regression

```
Fixed-effects (within) regression               Number of obs      =        91
Group variable: negara                          Number of groups   =         7

R-sq:  within  = 0.2005                         Obs per group:  min =        13
       between = 0.6931                                         avg =      13.0
       overall = 0.4770                                         max =        13

F(5,79)           =      3.96
corr(u_i, Xb)  = 0.4902                         Prob > F           =    0.0029

------------------------------------------------------------------------------
         fdi |      Coef.   Std. Err.      t    P>|t|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
    interest |  -.4135101   .1908291    -2.17   0.033    -.793346   -.0336742
     inflasi |  -.124592    .0953095    -1.31   0.195    -.3143007   .0651168
       gdpg  |   .456641    .1490975     3.06   0.003     .1598699   .7534121
    openness |  .0003100    .0001261     2.46   0.016     .0000587   .0005609
          td |   .001308    .0007617     0.17   0.864    -.0013853   .0016469
       _cons |   4.836375   1.321437     3.66   0.000      2.20612   7.466629
-------------+----------------------------------------------------------------
     sigma_u |  4.0460413
     sigma_e |  3.4772903
         rho |   .5751687   (fraction of variance due to u_i)
------------------------------------------------------------------------------
F test that all u_i=0:     F(6, 79) =     8.41                 Prob > F = 0.0000
```

★★★