

What is ASEAN's Attractiveness as A Foreign Investment-Friendly Destination?

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ABSTRACT

This study explains the attractiveness of ASEAN as a friendly region for foreign investment by looking at several factors that are variables to attract foreign investors to invest in ASEAN. These factors include the variables of the corruption perception index, the democracy index, the human development index and the crime index against foreign direct investment in 9 ASEAN countries in 2013-2022. The existence of foreign direct investment in a country can be useful as state revenue from tax sources, as well as useful for technology transfer, skills transfer, and increasing the level of national income in the economy. This study uses a quantitative method with secondary data and data collection through the World Bank, Transparency International, the United Nations Development Programme (UNDP), Numbeo, and The Economist Intelligence Unit. This study also uses panel data regression with the best model approach, namely the Random Effect Model (REM), to find out how much influence independent variables such as the corruption perception index, democracy index, human development index, and crime index on variables tied to foreign direct investment. However, the results of the t-test show that there are only two independent variables that have a significant effect on foreign direct investment, namely the human development index variable and the corruption perception index. The results of this study contribute to enriching the discourse for countries in ASEAN to attract foreign investment in investing in their countries.

Keywords: corruption perceptions index, democracy index, HDI, crime index, and foreign direct investment

Citation:

Royali, A. S., Oktavilia, S., Sholiha, F. U., & Sutikno. (2024). Conference Proceedings Paper: What is ASEAN's Attractiveness as A Foreign Investment-Friendly Destination?. *Proceedings of ASBN International Conference 2024* (pp. 696-702), Yogyakarta, Indonesia. ASEAN School of Business Network.

DOI: <https://doi.org/10.64458/asbnc.v1.56>

INTRODUCTION

Foreign Direct Investment (FDI) was an investment whose perpetrator was a foreign private company in another country. This type of investment provides more benefits when compared to indirect investments. Through Foreign Direct Investment (FDI) there was an exchange of managerial skills and expertise as well as the entry of various new technologies from investor countries to investment destination countries, thus supporting national productivity and output which ultimately has an impact on increasing the rate and national income. Meanwhile, when compared to other capital instruments such as loan credit, development financing, and export credit, Foreign Direct Investment (FDI) tends not to put a burden on the country's economy. Based on a survey conducted

by the United Nations Conference on Trade and Development (UNCTAD) on transnational companies, during 2013-2015, countries in the Southeast Asian region remain classified as priority countries intended as host countries for foreign direct investment. In the last span of time, ASEAN has transformed into one of the regions that investors look at to invest through FDI. The large population and vast territory create huge market potential, which encourages the entry of FDI flows into the ASEAN region. In addition, countries that are members of ASEAN have relatively cheap production costs (Kamis et al, 2023). Data published by the United Nations Conference on Trade and Development (UNCTAD) shows an increase in the number of FDI to Southeast Asia from year to year over the past 10 years, with the amount varying from country to country (UNCTAD, 2023).

Nine countries in the ASEAN region experienced changes in the number of FDI flows to their countries during the period 2013 to 2022. During that period, Singapore recorded the highest amount of FDI among nine other countries, while Laos recorded the lowest FDI compared to nine other countries. On the other hand, the Philippines and Vietnam showed a relatively stable upward trend of the nine ASEAN countries. Then countries in the ASEAN region need to examine factors that affect other FDI, such as corruption factors, democratic factors, human development index, and crime rates or criminality. Corruption perception index (CPI) was the most important factor that must be considered in investment matters because it will help and hinder the pace of investment in a country. Corruption will basically damage the economic system in developing countries and even developed countries. Therefore, once again it was necessary to conduct strict corruption review and supervision. So that corruption does not damage economic growth, economic stability can even inhibit foreign direct investment (FDI) (Abdul et al, 2018; Luu et al, 2019). Based on the CPI, Singapore recorded the highest CPI score among nine other countries, while Cambodia recorded the lowest CPI compared to nine other countries. On the other hand, Indonesia, the Philippines and Vietnam showed a relatively stable upward trend from nine ASEAN countries.

The factor that affects the next investment crime. Crime was very important consideration for an investor to invest in the destination country. In general, crime affects investment negatively. When a country has a high crime rate will cause loss and damage to property and create insecurity that will result in investors who have invested in the country, it will be a very important consideration by an investor when wanting to invest in a country (Brown & Hibbert, 2019; Jeke et al, 2021). In addition, the factor of democracy in research studies on the relationship between democracy and economics has long been discussed by researchers, although there was debate about the relationship between democracy and economics (Pinar & Stengos, 2021). According to the democracy index initiated by The Economist Intelligence Unit (EIU), democracy cannot be measured only in terms of civil or political freedom factors, because these components are not "strong" enough to identify the condition of democracy in a country. Based on the explanation above, this study aims to find out whether ASEAN as a region was friendly to foreign investment, to find out whether ASEAN was an investment-friendly region in nine ASEAN countries through the corruption perception index, democracy index, human development index, and crime index, towards foreign direct investment in 9 ASEAN countries.

LITERATURE REVIEW

ASEAN's attractiveness as a foreign investment-friendly destination can be analyzed through various indices, such as the corruption index, crime index, and democracy index. These indices provide insights into the political stability, governance quality, and overall business environment in the region. Corruption was a critical factor influencing foreign investment, as high levels of corruption can deter investors due to increased risks and costs. According to Transparency International's CPI, ASEAN countries show varying levels of corruption. Singapore consistently ranks among the least corrupt countries globally, which significantly boosts its attractiveness as an investment destination. Malaysia, Thailand, and Indonesia have made efforts to improve their standings, with varying degrees of success. However, countries like Myanmar and Cambodia still struggle with high corruption levels, which can hinder their appeal to foreign investors. Overall, while corruption remains a concern in certain ASEAN countries, the region's commitment to anti-corruption measures was gradually enhancing its investment climate (Anwar et al., 2023; Az Zakiyyah et al, 2024; Cung & Nhung, 2020; Husna & Nasir, 2024).

The crime rate in a country directly impacts its investment attractiveness by affecting the safety and security of businesses and their employees. According to Numbeo's Crime Index (Numbeo, 2023), ASEAN countries exhibit diverse crime rates. Singapore, once again, stands out for its

exceptionally low crime rate, making it a secure and attractive destination for foreign investors. Malaysia and Thailand have moderate crime rates, which are manageable and do not significantly deter investment. However, countries such as the Philippines and Indonesia face higher crime rates, posing challenges for foreign businesses. Despite these challenges, improvements in law enforcement and security measures are being implemented across the region, contributing to a more stable environment for investors (Sahu & Dash, 2021).

The level of democracy in a country can influence its attractiveness to foreign investors by affecting the predictability and transparency of its business environment (Basu et al, 2023). Based on The Economist Intelligence Unit's Democracy Index ranks ASEAN countries on a spectrum from full democracies to authoritarian regimes. Indonesia and the Philippines are considered flawed democracies, offering a relatively open political environment that can attract investors seeking transparency and stability. Malaysia and Singapore are categorized as hybrid regimes, providing a balance of political stability and economic freedom (Economist Intelligence Unit, 2023). However, countries like Vietnam, Laos, and Cambodia are classified as authoritarian regimes, where political uncertainties and lack of democratic processes can pose risks to investors. Nonetheless, the region's overall trend towards political reforms and greater openness bodes well for its investment attractiveness.

METHOD

The type of research used in this study was quantitative research, the research method based on the philosophy of positivism. The data used in this study are secondary data from 9 countries in the ASEAN region from 2013 to 2022. Data were obtained from several sources, namely: (a) Democracy Index (<https://www.economist.com/graphic-detail/2018/01/31/democracy-continues-its-disturbing-retreat>), (b) Corruption Perception Index (<http://transparency.org/en/cpi>), (c) Human Development Index (<https://hdr.undp.org/data-center/specific-country-data#/countries/IDN>), (d) Crime Index (<http://www.numbeo.com/>) and (e) Foreign Direct Investment (<https://data.worldbank.org/indicator>) in 2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020, 2021, 2022.

To estimate the effect of corruption perception index variables, democracy index, human development index, and crime index on foreign direct investment from 2013 to 2022, a panel data regression analysis model was used. In the process of power analysis using the help of *STATA 17.0 software*, this software was used to test each independent variable on the dependent variable either partially or simultaneously. Panel data regression model interpretation has three kinds of models, namely using *Regression Methods*, FEM (*Fixed Effect Model*), and REM (*Random Effect Model*). Using this model, the best interpretation of the model for research is obtained. To determine the best model between Regression, Fixed Effect, and Random Effect, one model estimation technique was used, namely the *Hausman Test* (Hausmann & Fernandez-Arias, 2000).

While the Hausman Test is a follow-up test in selecting panel data regression models. The Hausman test aims to determine which model was suitable between FEM and REM, in the Hausman Test will obtain a Chi-square Probability value that is smaller than alpha (α) ($0.0000 < 0.05$), meaning that REM is better used when compared to FEM, and vice versa if the Chi-square Probability value is greater than alpha (α) ($0.0000 > 0.05$), it means that REM is better used when compared to FEM. After determining the best model, the next step is the Statistical Significance Test. Statistically, there are two tests, namely the t test (*Individual Significance Test*) and the F Test (*Concurrent Significance Test*).

RESULTS

Regression of panel data can be achieved if it meets the Classical Assumptions to find out whether there are regression deviations in the research data. Based on the multicollinearity test shown in Table 1 which shows that all variables have a Variance Inflation Factor (VIF) value of less than 10 and $1/VIF$ of more than 0.1, it can be concluded that the regression model does not depend on the possibility of multicollinearity.

Table 1. Multicholinerity Test

Variabel	VIF	1/VIF
<i>Ln Corruption Perception Index</i>	2.41	0.415722
<i>Ln Crime Index</i>	1.94	0.514654
<i>Ln Democracy Index</i>	1.46	0.685625
<i>Ln Human Development Index</i>	1.07	0.938066
Mean VIF	1.72	

Sumber: data diolah

Table 1 shows that all variables have a *Variance Inflation Factor (VIF)* value of less than 10 and 1/VIF of more than 0.1. Then it can be concluded that regression models are independent of the possibility of multicollinearity.

1.1.1. Panel Data Regression Model Estimation

Regression analysis of panel data was used to determine the effect of corruption perception index variables, democracy index, human development index, and crime index on foreign direct investment from 2013 to 2022. Panel data regression model interpretation has three types of models, namely using the Regression method, FEM (Fixed). Effect Model), and REM (Random Effect Model). The estimation of the regression equation in the research model is as follows:

$$Y_{it} = a + \beta_1 X_{1it} + \beta_2 X_{2it} + \dots + \beta_n N_{nit} + e_{it} \dots$$

Which ones:

Y_{it} = Bound variables

T = T-th period

α = Constant

X_{it} = independent variable

i = I-th entity

e = Variables outside the model

Table 2. Model Estimation Results

Variabel	Regression		Fixed Effect		Random Effect	
	t-Statistic	P> t	t-Statistic	P> t	t-Statistic	P> t
<i>Ln Democracy Index (X1)</i>	5.06	0.000	0.37	0.709	2.41	0.016
<i>Ln Human Development Index (X2)</i>	1.66	0.101	0.29	0.772	0.96	0.339
<i>Ln Corruption Index (X3)</i>	7.28	0.000	-0.42	0.767	4.26	0.000
<i>Ln Crime Index (X4)</i>	0.44	0.663	0.61	0.543	0.71	0.476

Source: processed data

Based on statistical tests using the three models, it can be seen from Table 2 that there is a statistical t value of probability in each model as a result of panel data regression estimation. The calculation results in the table explain that each model has a different GIS value. To produce the best model in regression calculations, panel data will continue the analysis of the *Hausman test* (Hasanah & Ahmadi, 2017). Based on the *Hausman test*, this test was used to determine the best method between the Fixed Effect Model (FE) method and the Random Effect Model (RE). It is seen that Prob> chi2 is 0.1123 hence indicating that the best model is the *Random Effects Model* (RE). Meanwhile, based on classical assumption test testing, heterokedasticity is indicated, so the need for healing to meet panel data regression assumptions using the Robust method for final model improvement in this test using the REM model with Robust. Meanwhile, in the classical assumption test in this study, there was no need to do it because the selected model, namely the *Random Effect Model*, does not need to be tested for classical assumptions because REM estimation uses *Generalized Least Squares* (GLS). In the book Baltagi (2005) it was explained that GLS was an estimate that was assumed to be Best Linear

Unbiased Estimation (BLUE).

Table 3. Test Results *Random-Effects GLS Regression With Robust*

Random-effects GLS regression	Number of obs = 84
Group variable: Country	Number of groups = 9
R-squared:	Obs per group:
Within = 0.000	min = 8
Between = 0.8115	avg = 9.3
Overall = 0.7413	max = 10
	Wald chi2(6) = 68.56
corr(u_i, X) = 0 (assumed)	Prob > chi2 = 0.0000
Y	P>z Coefficient
Ln Democracy Index (X1)	0.083 .8612819
Ln Human Development Index (X2)	0.000 .0852703
Ln Corruption Index (X3)	0.001 .0415353
Ln Crime Index (X4)	0.543 .2416869
_cons	0.000 18.95095

Source: processed data, Stata 17

Based on the hausman test, the probability value of $0.0000 < 0.05$ which shows the selected model is *Random Effect*, then continued with the hausman test which shows a probability value of 0.1123 which means that *Fixed Effect (FE)* and *Random Effect (RE)* models can be used either. Thus, Table 3 shows that the *Random Effect model* was chosen as the best model, where there are only two independent variables that have a significant effect on *foreign direct investment*, namely the Human Development Index and the Corruption Perception Index.

Table 4. F-Statistical Test

Numb. of Observations	152
F(4, 79)	57.96
Prob > F	0,0000
Adj R-Square	0.7330

Source: Stata 17 Output Results

The F test was estimated to see the relationship or influence between the dependent variable and the independent variable together affect. The results of the panel data regression estimation shown in Table 3 obtained an F-statistical probability of 0.0000 which means less than the significance level ($0.0000 < 0.05$). It was also found that the Adj. R-Square value of 73.30% explained the magnitude of the influence of all independent variables on the dependent variable, while 26.60% was influenced by other factors outside the model. From the results of the t test using the *Random Effects (RE)* model with *Robust* can be seen with the determination of individual variables that do not have a significant influence out of the model, it produces the following equation:

$$Y = 18.95095 + 0.0852703 \cdot \ln HDI + 0.0415353 \cdot CPI + e \dots \dots \dots$$

The interpretation result of the regression equation of the panel data above is first, the value of the significant positive effect constant of *lnFDI* (Y) is 18.95095. The assumption was that if the variables *Human Development Index (lnHDI)* and *Corruption Perception Index (CPI)* remain the same, then the *lnFDI* rate will be 18.95095 percent. Second, in the Human Development Index (*lnHDI*) variable, a positive coefficient value of 0.0852703 was obtained, explaining that if every increase in

the *Human Development Index (lnHDI)* was 1 percent, there tends to be an increase in *lnFDI (Y)* of 0.0852703 percent. The results of the above test show that both partial and simultaneous economic growth and human development index affect the growth of foreign investment in the country. The interesting thing was it can be seen that the relationship was positive. The results of this analysis are interesting because they refute the initial assumptions of this research. Initially, it was suspected that the better a country's human resources, the lower the interest of foreign investors to invest. But the results of the analysis show different things even the opposite. This is because if the HDI is high, the country will be included in the category of developed countries, developed countries that have a high human development index, investing a lot of funds abroad. Examples of countries that enter developed countries include China, the United States, Japan and others. The United States is a country that is a foreign investor and the largest beneficiary of direct investment (Masters, 2018).

Third, the *Corruption Perception Index* variable obtained a positive coefficient value of 0.0415353, explaining that if every increase in the *Corruption Perception Index* of 1 percent, *there tends to be an increase in lnFDI (Y)* of 0.0415353 percent. Gelora Seven Saragih, Regina Niken Wilantari, and Fajar Wahyu Prianto (2020) Variables show that the Corruption Perception Index has a significant influence on FDI variables. Based on the increase in the Corruption Perception Index score, the amount of FDI will increase. And the results of this study show that there is an influence of the Corruption Perception Index on FDI thus *Ho* was rejected and *H1* was accepted. This is because foreign investors expect that the decreasing level of corruption in ASEAN 3 countries will improve the quality of bureaucracy from the government which will have an impact on making policies that benefit foreign investors themselves. These two variables have the most influence on foreign direct investment in the 9 ASEAN countries. This variable should be influential because when looking at the investor factor in determining the country to invest. So that was the main attraction for investors to invest in the country.

CONCLUSION

The main results of this study show that the influence of human development index and corruption perception index on foreign direct investment in 9 ASEAN countries. This finding proves that there was an influence of the hypothesis that has been observed to be true, the higher the ranking of the human development index and the corruption perception index, the increase in foreign direct investment. The results will make practical contributions in measuring the corruption perception index, democracy index, human development index, and crime index to increase foreign direct investment. Despite the interesting results, the study acknowledges the limitations of the study. Because of these limitations, the author suggests future research to add other indicators such as macroeconomic conditions, voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption in the form of indices.

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