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Determinants of Foreign Direct Investment in Organization of Islamic Cooperation (OIC) Countries' Economy

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Foreign Direct Investment; Political Stability; Government Efficiency; Form of Government.

ABSTRACT

The majority of organization of Islamic cooperation (OIC) countries are developing countries that need an investment to improve the welfare of the countries. This study analyzes the factor of political stability, trade openness, government performance efficiency and forms of government to foreign direct investment in the Organization of Islamic Cooperation (OIC) Countries. This study was quantitative using random effects model (REM). This research using the Data Panel to 57 member of organization of Islamic cooperation (OIC) countries with an annual distribution of data starting from 2000 – 2023. The result found that political stability, government efficiency, trade openness, and form of government are factors that have a relationship and influence on the investment climate. The results of this study contribute to enrich the discourse of political stability and government efficiency in Indonesia to attract foreign direct invesment (FDI).

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INTRODUCTION

Globalization that is taking place and will continue to occur with various kinds of impacts creates a very competitive growth climate among countries in the world (Kim & Lee, 2020; Song & Zhou, 2020; Korinek & Stiglitz 2021). Investment is one of the efforts to encourage the economy of a country in the time of globalization which creates a new economic order (Shittu, et. al., 2020; Zou, et. al., 2022; Wang & Sun, 2021). In case to compete healthily and improve the quality and quantity of a country's economy, investment become an option (Ramazanov, et. al., 2021; Zhang, et. al., 2022). There are two forms of investment, domestic investment and foreign investment (Osei & Kim, 2020; Qiu, et. al., 2021). Foreign direct investment (FDI) has more benefits than domestic investment because of capital inflows from outside the country into the recipient country of the investment funds (Sahu, 2021; Younsi, et. al., 2021; Islam, et. al., 2022). These funds can be used for various sectors such as human resource development, infrastructure, the real economy (Demir & Lee, 2022; Kurtović, et. al., 2022).

Many studies revealed that foreign direct investment has an impact on the formation of human resources, the integration of international trade, technology development and the establishment of a more competitive business in the country (Fagbemi & Osinubi, 2020; Hobbs, et. al., 2021; Mohamed, et. al., 2021; Rehman, et. al., 2021; Ayenew, 2022). In the current era of globalization, transactions that occur at the international level become a normal condition in the form of international trade, investment abroad, or doing business in another country (Kim & Lee, 2020; Luo, 2021; Shenkar, et. al., 2021). Grace (2019), Mujeri, et. al., (2020), Sibindi (2020), Yang, et. al., (2020) revealed that there are many factors that influence foreign direct investment, namely country governance and political risk, economic environment, exchange rate, trade, infrastructure, labour, market size and demand conditions, geographic proximity, economic agglomeration and culture. Kechagia & Metaxas (2022) found that political stability, the rule of law, the lack of violence, and regulatory quality draw foreign direct investment (FDI) into BRICS, but political stability, the absence of violence, regulatory quality, and government efficacy draw FDI into CIVETS.

In order to increase the economic growth of organization of Islamic cooperation (OIC) countries several policy can be implemented, one of these policy is to create a conducive climate for the entry of foreign investment (Ali, et. al., 2022; Medias, et. al., 2022; Naz & 2022). On the other hand, investment can be fungtioned as a fiscal instrument that can be intervened by the government to increase or stabilize government spending (Islam, et. al., 2020; Ali, et. al., 2022; Shinwari, et., al., (2023). However, the intensity of trade between the OIC countries is very low which causes the level of convergence between countries to be relatively high (Naz & 2022). It is necessary to strengthen trade relations between OIC member countries to accelerate economic growth

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Vol. 9 No. 1 (2024)
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(Sheikh, et. al., 2021; Eldeeb, et. al., 2023). Another aspect that is considered important to increase growth and reduce disparities among member states is to reduce the rate of population growth and improve institutional development at the local, national and regional levels of government (Yaumidin, 2017; Ali, et. al., 2021; Eldeeb, et. al., 2021).

Several studies have been conducted the factors influence foreign direct investment in participation in Gross Domestic Product in OIC Countries. Sajilan, et. al., (2019) found that factors attracting foreign direct investment (FDI) to such countries is positively and strongly correlated with infrastructure, trade openness, and economy size. Supriani & Fianto (2020) found that FDI is influenced by gross domestic product, trade openness, exchange rate, inflation and human development index with a sample of 10 OIC member countries. On the other hand, Ali, et. al., (2020) found there were a large and negative correlation between institutional performance and ecological footprint, trade openness, foreign direct investment, and urbanization all have a positive and significant link with ecological footprint. Furthermore, Sahoo & Sethi (2020) found that FDI for a developing country is an important source because of the possibility of a lower capital flow reversal. While Ali, et. al., (2022) found that long-term estimations, trade openness positively correlates with unemployment in higher-income OIC nations and significantly and negatively correlates with the unemployment rate in overall and lower-income OIC economies. Rehman, et. al., (2022) found that the Islamicity effect becomes weaker as the economy grows regardless of whether a country is an OIC member. Moreover, Liu, et. al., (2022) and Ulima (2022) revealed that the long-term findings show that trade openness has a positive correlation with youth unemployment and total unemployment in the higher-income OIC group and an inverse and significant relationship with both in lower-income and all OIC economies.

Dzihny, et. al., (2023) found that foreign direct investment has a large negative impact on HDI, while trade openness has a big favorable impact. Trade openness can boost wealth through increased demand, supply, and services in many industries, so strengthening the economy, education, and health all at once. On the other hand, Bhatti & Ghouse (2023) revealed that the Covid-19 dummy variable has a considerable impact on trade and is significant in all models. Syed, at. al., (2024) found in their analysis on foreign direct investment and green growth in OIC countries that policies with an outward orientation are believed to promote economic growth because they can increase an economy's overall productivity and efficiency by attracting foreign direct investment or productivity spillovers from importing more advanced technologies.

This study aims to measure the effect of political stability, trade openness, government efficiency, and form of government on FDI in OIC member countries. This research is expected to provide an initial picture for OIC member countries in improving the sectors that need to be addressed to increase or attract FDI into OIC member countries

Vol. 9 No. 1 (2024)
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while strengthening OIC economic relations which are still weak and have little impact on the economy because the OIC is more focused on problems. The politics of the western world and the Islamic world instead of becoming OIC member countries are increasingly independent and can work together to improve the economy of Muslim countries or countries with large Muslim populations.

RESEARCH METHOD

This study was quantitative research that used panel data method. Panel data (time-series data) is a data set in which the behavior of an entity is observed over time (Torres-Reyna, 2007). Panel data used in this research to control for variables measurement such as cultural factors or differences in business practices across countries (Aparicio, et. al., 2016). Panel data estimates many advantages over cross-section and time-series data because they control individual heterogeneity (Han, et. al., 2010). Utilizing panel data method is the way to reduce collinearity between exogeneous variables through large degrees of freedom. In panel data analysis has many estimation techniques have been used (Kim, 2016).

This research following Belotti, et. al., (2017) descriprion on the general steps of regression using panel data, namely: *first*, to determine the method used. There are 3 (three) types of methods used, namely: Pooled Least Square (PLS) or Common, Fixed Effect Model (FEM), and Random Effects Model (REM). *Second*, to determine what method is used to analyze the panel data. Determine the method by using several tests, namely the Chow Test, Hausman Test, and Lagrangian Multiplier Test. *Third*, to proceed with classical assumptions because the assumptions used are the same as those used in the Ordinary Least Squares (OLS) method and if the model chosen is REM, it is also continued with classical assumptions but does not include the Autocorrelation test and Heteroscedasticity because the assumptions used are the same as those used in the Generalized Least Square (GLS) method.

The regression equation of this research is written as follows:

$$FDI_{it} = \alpha + \beta_1 PSI_{it} + \beta_2 TRO_{it} + \beta_3 GE_{it} + \beta_4 FOG_{it} + e_{it}$$

FDI	: Foreign Direct Investment
PSI	: Political Stability
TRO	: Trade Openness
GE	: Government Efficiency
FOG	: Form of Government
e	: error term

Vol. 9 No. 1 (2024)
ISSN (print): 2502-3918 | ISSN (online): 2502-7824

Table 1. Variables and source of data

Foreign Direct Investment	**World Bank Data** **https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS?end=2022&locations=ID&skipRedirection=true&start=1970&view=chart**
Political Stability	**World Bank Data** **https://databank.worldbank.org/source/worldwide-governance-indicators**
Trade Openness	**World Bank Data** **https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS**
Government Efficiency	**World Bank Data** **https://tcdata360.worldbank.org/indicators/h8125e315**
Form of Government	**National Geographic** **https://www.nationalgeographic.org/maps/forms-government-2021/**

RESULT AND DISCUSSION

This research using the Data Panel to 57 member of organization of Islamic cooperation (OIC) countries with an annual distribution of data starting from 2000 - 2023 to see the factors that affect the investment of those countries. By using Stata 15, it was found that this study used the Random Effect Model (REM) due to random sampling data collection used. This is also proven through the Lagrangian Multiplier (LM) test with the following values in the table 2.

Table 2. The Result of Lagrangian Multipler Test

Lagrangian Multiplier (LM) Test	
Prob > | Chi^2 |	.000

This technique indicate errors that it may correlate to the cross-section and time-series which can only be used through the RE Model. Therefore, the results obtained in the form of the regression equation described as follows:

$$FDI_{it} = 16,387 + 0,651PSI_{it} + 0,352TRO_{it} + 2,821GE_{it} + 3,046FOG(R)_{it} + e_{it}$$
$$(0,305)^{*} \quad (0,381) \quad (0,566)^{***} \quad (1,239)^{**}$$

Vol. 9 No. 1 (2024)
ISSN (print): 2502-3918 | ISSN (online): 2502-7824

Table 3. the Result of the Random Effect Model REM Test

Political Stability	**Coef**	.651
	Std error	.305
	Sig.	.033
Trade Openness	**Coef**	.352
	Std error	.381
	Sig.	.356
Government Efficiency	**Coef**	2.821
	Std error	.566
	Sig.	.000
Form of Government	**Coef**	3.046
	Std error	1.239
	Sig.	.014
Constant	**Coef**	16.387
	Std error	2.008
	Sig.	.000
Lagrangian Multiplier test		.000
Multicollinearity test		5.21
Normality test		0.000

Based on the results of the Random Effect Model (REM) in the table 3, it was found that political stability has a significant and positive relationship with foreign direct investment (FDI). For example, when there is one point increase in political stability, FDI will automatically increase by 0.651 points. Furthermore, it can be interpreted that if a country has a high and good political system or political stability, it will also invite investors to invest in that country and vice versa. However, the facts on the ground can be concluded that in general the OIC member countries still have problems in politics in their respective countries, especially Middle Eastern countries or countries that are still under development that have domestic and foreign political turmoil. So, it can be concluded that if these countries can improve a conducive atmosphere in domestic and foreign politics, their economic growth can be increased through the FDI variable.

The result of the study in line with Yu, & Li (2020) and Shabbir, et. al., (2021) revealed findings on the impact of political stability on FDI, which has led to an investigation of political stability to understand its impact on FDI inflows in the context of Asia Pacific countries. Politically motivated corruption significantly reduces FDI inflows in certain Asian countries (Shah, 2018; Sabir, et. al., 2020; Shaari, et. al., 2022).

Moreoever Macaulay (2020) revealed that political intervention is good then the country has political stability otherwise, the country has political instability. If the government is not able to guarantee the right to private property and labor output,

Falah: Jurnal Ekonomi Syariah
Vol. 9 No. 1 (2024)
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investment decisions will be influenced by uncertainty, reducing available aggregate savings given the increase in the accumulation of money, light capital (Yan, 2020; Singer, 2022). Further, low political stability, it will make the level of certainty low, the level of certainty in question is information disclosure, bureaucracy, government work efficiency, and the level of corruption (Singer, 2022).

Khan, et. al., (2022) shows that improvements in corruption control, political stability, regulatory quality, and government effectiveness have a positive impact on FDI inflows for several Latin American countries. Political stability has a positive impact on the investment climate which increases the flow of FDI flows and increases economic growth (Aust, et. al., 2020). Political stability is very much needed to maintain a country that can control the upheaval that occurs, even though in a democracy the demonstrations will continue to occur, which is likely to damage macroeconomic stability (Acquah, & Ibrahim, 2020).

On the other hand, investment has an important things to drive economic matter because inflow of capital formation to increases production capacity, national revenue, and creates new and better jobs (Shabbir, et. al., 2021). Domestic investment according to the Investment Coordinating Board is a productive resource from the Indonesian people that can be used for economic development which is part of Indonesian wealth including rights, objects (movable and immovable) that can be set aside or provided to run a company business (Shabbir, et. al., 2021).

According to Maharani & Saputra, (2021), there are a number of factors that greatly influence the investment climate in Indonesia. These factors concern not only political and social stability, but also economic stability, the condition of basic infrastructure (Singer, 2022). Meanwhile investment from abroad or also known as Foreign Direct Investment (FDI) is a fresh funs that flow from abroad that came into the private sector either through direct or indirect investment in the form of a portfolio (Maharani & Saputra, 2021).

On the other hand, the result of study dounf that there is no significant relationship between trade openness and foreing domestic investment (FDI) by .352 points. This result in contrast with many previous studies which found that trade openness had significant relationship with FDI as study by Supriani & Fianto (2020) which found trade openness affect on the increase number of FDI. This is different due to the lack of intimate relations in the trade sector between OIC member countries. Not much different, the investment relationship of the OIC member countries to one another is not very close to each other. On the other hand, Makoni (2018) found a positive significant relation between trade openness and FDI. In line with the result, Mudiyanselage et. al., (2021) trade openness attract foreign domestic investment (FDI). Countries that are more open to trade have higher stocks of FDI inflows. Jahanger (2021) found that The more open a country's economy is, the less effort a country needs to attract FDI, but it still has a positive impact on attracting incoming FDI.

Trade Openness is obtained from trade percentage data from Gross Domestic Product (GDP) (Banday, et. al., 2021). Each country will depend on goods or services produced or provided by other countries in meeting all domestic needs because not all goods and services needed can be produced domestically (Utting, 2022). According to Irwin (2020), free trade policy is the best policy for every country in the world. Countries can benefit by specializing in each country in producing commodities that have an absolute advantage if it is more efficient and effective than another country (Shen, et. al., 2022).

In the Heckscher-Ohlin theory model, it is explained that a country will export commodities which to produce it absorbs more production factors which are relatively cheaper and abundant in that country (Kunroo & Ahmad, 2023). Krugman explains that countries that are globally integrated into an open economic system will open up international trade trying to increase competitiveness to gain trade benefits and increase economic growth (Gaspar, 2020).

Based on the result of study, it was found that there is a significant and positive relationship between government efficiency on foreign domestic investment (FDI). When the government's performance is good or increases by 1 point, FDI will also increase by 2,821 points. This means that the higher the efficiency of the government is working and making policies, the FDI inflows will certainly increase as well. This government efficiency is used as a substitute for government bureaucratic affairs in looking at the relationship to FDI.

This result in line with the study by Azam (2022) which found the improvements in corruption control, political stability, regulatory quality, and government efficiency have positive effects on FDI inflows for several Latin American countries. While Khan, et. al., (2022) examined which elements of governance institution quality influence foreign investors' decisions and found the unusual, unpredictable and uncertainty policies which change over time, excessive regulatory burdens, and lack of government commitment hinder FDI inflows. This results provide evidence that improving the quality of government regulations is critical indicator in creating environmentally profitable businesses and investments. (Semenas, 2020). Institutional reforms can contribute to improving governance, promote the investment climate, and help attract more Foreign Direct Investment (FDI).

Government efficiency is oriented towards fitting services closer to citizens' preferences (Acquah & Ibrahim, 2020; Yu & Li, 2020). Several studies showed a better governance create a better development output such as, economic growth, public investment, foreign direct investment, social infrastructure and reducing the mortality

Falah: Jurnal Ekonomi Syariah
Vol. 9 No. 1 (2024)
ISSN (print): 2502-3918 | ISSN (online): 2502-7824

(Aust, et. al., 2020; Li, et. al., 2021; Shabbir, et. al., 2021; Nguyen, 2022). Governance is a concept of multi-faceted includes all aspects of exercising authority of formal and informal institutions in managing state resources (Santini, et. al., 2021; Abbott & Faude, 2022). Its efficiency refers to whether the public administration does well what it is supposed to do, whether the people in this entity work hard and well, whether the actions and procedures of the public organization and its members help to achieve the goals, and ultimately, whether it achieves its mission (Julio, et. al., 2021).

The results of this study indicate that form of government have a significant and positive relationship with FDI. In this case, the Republican form of government is better than the Kingdom with a difference of 3,046 points. When a country has a republican form of government, it will have an advantage of 3,046 where the FDI inflow is greater than that of a royal/monarchy system country. This result in line with study by Contractor, et. al., (2020) and Yeboua, (2021) revealed that there were relationship between the form of government and Foreing Direct Investment (FDI).

Government is all forms of activities by state administrators carried out by state agencies that have the authority or authority to exercise power to achieve goals (Rosenbloom, 2022). There are general forms of government, namely the Republic and the Kingdom. A republic is a form of state led by a president and a kingdom led by a king as head of state and a prime minister as head of government if it's a parliamentary monarchy (Tompkins, 2023). The form of government is generally divided into two forms, namely Republic and Kingdom where 48 countries are classified as Republic form of government and the rest are Kingdom form. Where Malaysia is categorized as a country in the form of a republic because a parliamentary monarchy is closer to a republican system than an absolute monarchy.

CONCLUSION

Based on the result, it can be concluded that the political stability of a country, the efficiency of government performance, and the form of government have a relationship and influence on foreing domestic investment (FDI). The result provides a useful contribution to enrich the discourse of political stability and government efficient, especially in making both of this variable in good or better conditions. Many factors encourage investors, whether individuals, companies, or countries, to invest in a country.

However this study acknowledge limitation, this study only focuses in limited variables such as political stability, government efficient and form of government. Further study should add more variable such gross domestic product (GDP) and human development index (HDI) to get better research results to describe the factors that influence foreign direct investment in Islamic organization countries (OIC).

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