Macroeconomics, Domestic Credit and Institutional Quality on Foreign Direct Investment in ASEAN

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Info Article	*Abstract*
   	Foreign Direct Investment (FDI) is one of the external capital flows that has many benefits for the host country in closing the savings and investment gap. The purpose of this study is to examine and explain the factors that affect the inflow of foreign capital to ASEAN countries from 2013-2022 through a fixed effect model approach. This study found that economic growth, open trade, and total domestic credit have a significant positive effect while institutional quality has a significant negative effect on FDI inflows in ASEAN countries. The findings of this study provide implications that can be taken into consideration for government agencies to make policies that are on the conditions of each country to attract investors to invest in ASEAN countries, especially in maintaining the country's economic growth rate, ease of access to global trade and finance followed by improvements in terms of bureaucratic reform of institutional quality.

INTRODUCTION

The traditional Neoclassical growth model explains that differences in countries' per capita income are caused by differences in capital accumulation between savings and investment rates (Todaro & Smith, 2011) . This difference will create a savings-investment gap which will hurt economic growth. Sabir & Khan (2018) stated that foreign *direct* investment flows can be an alternative source in filling resource gaps and capital flows in developing countries. FDI can facilitate economic development through improved technology, better management skills, and increased capital accumulation (Chandra & Handoyo, 2020; Hunady & Orviska, 2014) . The increasing competition between developed and developing countries has led many developing countries to adopt policies to facilitate FDI inflows such as financial, and structural sector adjustment programs, economic recovery, and partnership agreements between countries (Asamoah et al., 2019) .

The Association of Southeast Asian Nations or ASEAN is an organization whose members are Southeast Asian countries including Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam to bring prosperity and advancement to its member countries. In addition, based on *ASEAN statistical highlights* published by *The ASEAN Secretariat Community Relations Division*, ASEAN countries are one of *the economic groupings of* potential developing countries with a total combined Gross Domestic Product (GDP) of around

3.6 trillion US$ in 2022 which occupy the position top five in the world. However, of the 10 ASEAN countries, only two member countries recorded an increase in FDI in 2020. Meanwhile, the overall FDI inflow from the pre-pandemic annual average of 7.4% in 2011-2017 to 11% in 2018 -2019 and 11.07% in 2020-2021. Strong inflows pushed FDI flows in the ASEAN region to 3.1 trillion US$, an increase of around 72% from 2015 (1.8 trillion US$). On the other hand, ASEAN countries in recent years have attracted world attention through their dynamic and stable growth and are predicted to become one of the five largest economies in the world shortly (Kurniasih, 2020). However, most of the countries in ASEAN are developing countries with stable economic growth. Similar to other developing countries. These countries have always had a high demand for capital investment due to low gross domestic savings rates (Sabir & Khan, 2018).

The eclectic theory developed by Dunning in 1980 states that the determining factors influencing FDI inflows are motivated by three main aspects, namely ownership advantages*, location* advantages, and international specific advantages (*Internalization*) (Dunning, 1980) . Derived from locational advantages and Dunning's eclectic OLI paradigm, it is the basis for multinational companies in investing in a country based on the motives of *resource-seeking*, *market-seeking*, *efficiency-seeking,* and *strategic-seeking.* (Dunning & Lundan, 2008; Kamal et al., 2019) . According to this theory, investors also pay considerable attention to various macroeconomic factors before investing in a country. Kamal et al (Kamal et al., 2019) stated that GDP per capita is one of the variables that reflect *market-seeking motives.*

Countries with high economic growth are a particular attraction for investors to expand their target market because they reflect the high purchasing power and rate of return received by investors. (Putri et al., 2023) . This is also strengthened by the ease of achieving global market access to attract much greater FDI. Research by Asongu et al (2018) and Putri et al (Putri et al., 2023) found that both in the combined BRICS countries (Brazil, Russia, India, China, and South Africa and MINT (Mexico, Indonesia, Nigeria, and Turkey) and in 8 developing countries (Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey) market share and open trade are the most important factors in attracting FDI. In contrast to Wickramarachchi's research (2019) found that there was no significant influence between economic growth and open trade on significant FDI flows.

Although many factors of FDI attraction have been studied in a country, financial sector growth has been least explored in the literature. The growth of the financial sector serves as a symbol of investor confidence and is considered sustainable economic progress. A country's financial system will allocate capital resources reduce production costs and increase product market competitiveness through productivity efficiency by increasing the use of technology and equipment periodically which can be supported by the availability of capital resources in a country. Islam et al (2020) their research found that the development of the financial sector had a significant influence in attracting FDI inflow in 79 countries. Then research by Pham et al (2022) shows a two-way causal relationship between *financial development* and FDI. They also explained that a well-developed country's financial sector will attract more FDI to the host country. This is different from Phung's research findings (2016) which confirms that *financial development* does not have a significant effect on FDI in developing countries.

FDI entering a country is also inseparable from the quality of an institution. Some researchers consider institutional quality to be the most important indicator of attracting FDI (Asamoah et al., 2019; Paul & Jadhav, 2020; Saha et al., 2022) . Poor institutional quality can impact FDI. Investors do not want to invest in countries where institutions encourage corruption, nepotism, and poor bureaucracy. The institutional theory put forward by North (1990) explains that good institutions influence economic activity through several different channels such as reducing transaction, manufacturing, and production costs. Meanwhile, markets with poor institutions are likely to create barriers to FDI entry because poor institutional quality will increase tax costs, make investments more expensive, and increase uncertainty. This uncertainty is caused by a lack of information relating to economic transactions and transaction costs which contain risk premiums. The risk premium is a function of institutional quality that plays a role in protecting property rights, contractual provisions and guarantees against the possibility of default by other parties (North, 1990; Peres et al., 2018) .

Sabir et al.'s research (2019) in examining the influence of institutional quality on FDI inflows in developing and developed countries, found that institutional quality has a positive and significant relationship with FDI inflows in both developed and developing countries. In line with Lucke & Eichler (2016) which confirms the existence of a positive relationship between institutional quality and FDI in developing countries. This shows that foreign investors are more interested in political stability to invest or invest their capital. Contrary to Peres et al., (Peres et al., 2018) which analyzes the impact of institutional quality on FDI inflows in developed and developing countries. His research found that institutional quality has an insignificant impact on FDI in developing countries due to weak institutional structures.

Most previous research focuses on macroeconomic factors such as GDP per capita, economic growth, and open trade as the main attractors of *Foreign Direct Investment* (FDI) in developing countries. These studies find that growing and open markets tend to attract more FDI. However, some studies show different results, where these factors do not always have a significant influence. In addition, although institutional and financial sector quality have been identified as important factors in the literature, there is still a gap in research that comprehensively examines how financial sector development and institutional quality specifically influence FDI flows in ASEAN countries.

Therefore, based on the background explanation above, This research differs from previous research by examining the determinants of FDI flows in ASEAN countries from 2013-2022, including financial sector development and institutional quality, which are less explored in the literature. This research also considers the specific context of ASEAN countries which have different economic and institutional characteristics compared to other developing countries. It is hoped that the results of this research can guide policymakers in ASEAN countries in attracting FDI through improving institutional quality, bureaucratic reform, better global market access, and financial sector development.

METHOD

The type of data in this research is quantitative using a causality approach. Research data comes from worldbank.org. The population in this study is all ASEAN

countries. Meanwhile, sample determination was carried out using a purposive sampling technique with certain criteria. The ASEAN countries in the sample are Brunei Darussalam, Cambodia, Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam. The countries Myanmar and Laos were not included in the sample because the available data was incomplete according to the sample criteria.

Furthermore, to meet the criteria for the *Best Linear Unbiased Estimator model* (BLUE) then it is necessary to test the classical assumption which consists of several tests, namely: The normality test is carried out to determine whether in a regression model, the independent variables and dependent variables, both individually and together, have a normal distribution or not, the multicollinearity test aims to find out whether there is a correlation between the independent variables or independent variables in the regression model, the heteroscedasticity test aims to test whether there is a discomfort variable from the residuals in the regression model from one observation to another, and the autocorrelation test. Autocorrelation can arise because of the link between consecutive observations over time. This problem arises because the residuals are not independent between one observation and another (Ghozali, 2016). Meanwhile, choosing the best research model can be done by testing model specifications which include *Common Effect Model* (CEM), *Fixed Effect Model* (FEM) and *Random Effect Model* (REM). If the model chosen in the Hausman test is FEM, then the LM test does not need to be carried out.

The method used in analyzing data is multiple linear regression analysis. As for variables The dependent in this research is *foreign direct investment* using the FDI *net inflows* (*current* US $) proxy. Meanwhile, the independent variables used include economic growth proxied by GDP per capita and open trade proxied by trade % of GDP according to research, and financial sector development which is proxied by the ratio of private credit in banking to GDP referring to research (Phung, 2016) and institutional quality which is proxied by the average value of 6 state governance indicators between corruption control, government effectiveness, political stability, regulatory quality, legal rules, and accountability voice developed by. The multiple linear regression model equation in this research is as follows:

$$FDI = \alpha + \beta 1 GDP_{it} + \beta 2 TO_{it} + \beta 3 CRD_{it} + \beta 4 IQ_{it} e_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots(1)$$

Where: FDI = *foreign direct investment*; GDP = economic growth; TRADE = open trade; CRD = total domestic credit; IQ = quality of institution; β = coefficient; i = 2013 - 2022 and e_t = error term.

RESULTS AND DISCUSSION

Research result

Table 1 shows the results of testing the panel data estimation model using the common effect, fixed effect, and random effect model methods using the Chow test and Hausman test approaches in selecting the best research model.

Table 1. Panel Data Regression Estimation Results

Variable	Common Effects		Fixed Effects		Random Effects	
	t-statistic	Prob	t-statistic	Prob	t-statistic	Prob
C	1.1910	0.0000	-8.2009	0.0026	-1.8009	0.6872
GDP	8.9508	0.0007	1.3108	0.0805	3.3108	0.0344
TRADE	-84682	0.0050	1.2808	0.0000	695941	0.0459
CRD	52341	0.0728	24000	0.08030	287104	0.2618
IQ	1.7709	0.4033	-1.2410	0.0080	-3.3209	0.4462

Adj. R ^{2}	0.185801	0.914212	0.161822
Prob. (F Stat)	0.001545	0.000000	0.020181
Chow		0.0000	
Hausman			0.0253

From the test results using the Chow test approach, it is known that the probability of Cross-section F is 0.0000, which means it is less than the alpha level of 0.05, so the FEM model is the selected model. In the next testing stage, namely using the Hausman test, it was discovered that the Chi-Square probability value was 0.0253, less than the alpha significance level of 0.05. So it can be concluded that the best model in this research is the *Fixed Effect* Model (FEM).

Classical Assumption Testing

From the results of the normality test that has been carried out, it is known that the Jarque-Bera probability value of 0.473257 is more than the alpha significance of 0.05 so the model used is normally distributed. Furthermore, from the results of the multicollinearity test in Table 2 which was tested using the pairwise correlation method, it is known that the independent variables consisting of GDP, TO, CRD, and IQ have a correlation value of less than 0.80, so it can be concluded that there is no correlation between the variables, which means The research model does not contain multicollinearity problems.

Table 2. Multicollinearity Test

Variable	GDP	TRADE	CRD	IQ
GDP	1,000000			
TRADE	0.118468	1,000000		
CRD	0.074027	0.699232	1,000000	
IQ	-0.436563	0.002548	-0.220441	1,000000

Table 3. Heteroscedasticity Test

Variable	t-statistic	Prob
GDP	2.790906	0.0071
TRADE	-1.125765	0.2648
CRD	-0.295544	0.7686
IQ	0.608124	0.5454

Heteroscedasticity testing was carried out using the Park Method. The test results in Table 3, show that all independent variables, namely GDP, TRADE, CRD, and IQ have a probability greater than the alpha significance of 0.05, so the model does not have residual similarities between the variables, which means the model is free from heteroscedasticity problems. Next, in testing the autocorrelation problem, researchers used the Durbin-Watson method as a basis for decision-making. From the results of the tests that have been carried out, it is known that the DW value is between the Du and 4-Du values, namely $1.7351 \leq 1.885631 \leq 2.2649$ (Du $\leq$ DW $\leq$ 4-Du) which means that the model is free from confounding errors from the previous period or the model is free from autocorrelation problems.

Testing the Significance of Regression Models

From the results of selecting the best model, it shows that FEM is the right model. Therefore, the FEM model is the right model to explain the determinants of FDI in ASEAN countries.

Table 4. Results of Partial Significance Testing (T-Test) - *Fixed Effect Model*

Variable	Coefficient	t-Statistics	Prob.
C	-8.2109	-3.139595	0.0026
GDP	1.3108	1.778522	0.0805
TRADE	1.2808	5.917549	0.0000
CRD	240004	3.096187	0.0030
IQ	-1.2410	-2.746827	0.0080
Adjusted R ^{2}		0.914212	
Prob. (F Stat)		0.000000	

From the results of panel data regression analysis testing shown in Table 4 using *the Fixed Effect Model* (FEM), the model equation in this research is as follows:

FDI = -8.2109 + 1.3108 (GDP) + 1.2808 (TO) + 24000 (CRD) –1.2410 (IQ)................(2)

The test results in Table 4 show that the coefficient value of the economic growth variable (GDP) is 1.3108, the statistical t value is 1.778522 and the probability value is 0.0805, less than the alpha significance value of 0.10. This means that the DGP variable partially has a positive effect on FDI flows to ASEAN countries.

The test results in Table 4 show that the open trade coefficient (TO) value is 1.2808, the statistical t-value is 5.917549 and the probability value is 0.0000, which is less than the alpha significance value of 0.01. This means that the TRADE variable partially has a positive effect on FDI flows to ASEAN countries.

The test results in Table 4 show that the coefficient value of the domestic credit variable (CRD) is 240004, the statistical t value is 3.096187 and the probability value is 0.0030, less than the alpha significance value of 0.01. This means that the CRD variable partially has a positive effect on FDI flows to ASEAN countries.

D The test results in Table 4 show that the coefficient value of the institutional quality variable (IQ) is -1.2410, the statistical t value is 2.746827 and the probability value is 0.0080, which is less than the alpha significance value of 0.01. This means that the TRADE variable partially hurts FDI flows to ASEAN countries.

Furthermore, table 4 shows that the Prob(F-Statistic) probability value of 0.00000 is less than 0.01. This means that there is a simultaneous influence between the variables income, economic growth (GDP), open trade (TO), domestic credit (CRD), and the availability of institutional quality (IQ) on FDI inflows to ASEAN countries. The *Adjusted R-Squared* value is 0.914212, which means that the ability of the independent variables which include economic growth (GDP), open trade (TO), domestic credit (CRD), and institutional quality (IQ) in influencing FDI flows to ASEAN countries is 91%. while the remaining 9 % is explained by other variables not included in this research.

Research Discussion

Economic Growth on *Foreign Direct Investment*

From the results of the tests carried out in Table 4, it is known that economic growth has a positive and significant influence on the inflow of *foreign direct*

investment in ASEAN countries. This research supports Dunning's eclectic theoretical framework which states that the large market share of a country can attract multinational companies to provide loans in that country. In line with the results of research conducted by; Putri et al., 2023) where a country's GDP level has a significant positive effect on FDI in the host country. Furthermore, Asongu et al (Asongu et al., 2018) explained that market share as proxied by GDP is a reflection of a country's purchasing power and is a benchmark for the rate of return on investments that have been made. Therefore, countries with high economic growth are one of the factors considered by multinational companies in channeling their capital to host countries which is supported by high product sales so that it can provide profits for the company.

Open Trade to *Foreign Direct Investment*

Based on Table 4, it is known that open trade (*trade openness*) has a significant positive effect on FDI inflows to ASEAN countries. The results of this research are in line with (Asongu et al., 2018; Sabir et al., 2019) which found that open trade has a positive impact on FDI inflow. Chandra & Handoyo (Chandra & Handoyo, 2020) explained that multinational companies will choose countries with high levels of open trade to meet their export needs. This is also reinforced by Phung's research (Phung, 2016) which emphasizes the importance of developing countries lowering trade barriers and investing in all types of infrastructure to attract FDI. The significant positive relationship between open trade and FDI in ASEAN countries in this study could also be due to the implementation of trade liberalization in each ASEAN member country to facilitate a conducive environment for FDI inflows. Therefore, the more open a country's economy is, the greater the FDI entering the host country.

Domestic Credit to *Foreign Direct Investment*

Then, from the results of the tests carried out in Table 4, it is known that financial growth as proxied by total domestic credit has a significant positive influence on FDI inflows to ASEAN countries. The results of this study are in line with the research (Desbordes & Wei, 2017; Islam et al., 2020 ; Pham et al., 2022) . A better-developed financial sector in a country will make that country more attractive for foreign investors or multinational companies to invest their capital. As stated by Desbordes & Wei (Desbordes & Wei, 2017) that the growth of the financial sector can directly increase access to external funding and indirectly encourage manufacturing activity in a country. This argument was also strengthened by Nguyen (Nguyen, 2022) stated in his research that explains that developments in the financial sector can strengthen the positive impact of incoming foreign direct investment in encouraging economic growth through the role of the financial sector in providing capital allocation to increase productivity efficiency. Therefore, easy access to capital through the provision of domestic credit will have an impact on improving a country's infrastructure so that it can create a positive and sustainable business environment in the host country.

Furthermore, from the results of the tests carried out in Table 4, it is known that institutional quality obtained from the average value of indicators of state governance which include corruption control, government effectiveness, political stability, regulatory quality, legal regulations and voice of accountability has a negative influence. significant impact on FDI inflows to ASEAN countries. This negative relationship was also found by (Baklouti & Boujelbene, 2014; Belgibayeva &

Plekhanov, 2019) using corruption control as a proxy for institutional quality which confirms that an increase in corruption will lead to a decrease in FDI inflows. The results of this research support the institutional theory put forward by North (North, 1990) that markets with poor institutions are likely to create barriers to FDI entry because they will increase tax costs, make investments more expensive, and increase uncertainty due to a lack of information relating to economic transactions and transaction costs that contain risk premiums. This negative relationship is also strengthened by the low level of institutional quality in ASEAN countries which is still at -0.11, this shows that institutional quality has a very important role in FDI flows.

CONCLUSION

ASEAN countries are one of the developing countries which is estimated to have great potential in attracting FDI inflows. This research aims to examine and analyze the relationship between macroeconomics, domestic credit, and institutional quality on *foreign direct investment* (FDI) in ASEAN countries from 2013 to 2022. Researchers used multiple linear regression methods and found that economic growth, open trade, and total domestic credit have a significant positive influence while the quality of institutions has a significant negative influence on FDI entry into ASEAN countries.

The results of this research have several implications, especially for ASEAN countries to maintain a friendly investment climate for investors by increasing economic growth supported by easy access to global trade so that it can be a consideration for foreign investors and multinational companies through the rate of return on profit on investment. that have been invested in carrying out business expansion. Then, the government must also pay attention to good institutional infrastructure to increase growth in the financial sector by providing effective regulations and legal systems, protecting investor contractual rights, and guaranteeing property rights. On the other hand, improvements in the bureaucratic system and the quality of institutions supported by information transparency, low corruption, political stability, and clear legal regulations also motivate more investors to get involved in increasing access to capital (FDI) to host countries.

This research has limitations in the number of variable indicators used. Further research can add other variables such as human capital, taxes, or education level and use different methods to test the factors that influence FDI inflow. Thus, the overall significance of the model mentioned in this research is expected to better describe how it works and contribute to a better understanding of the determinants of FDI in emerging markets.

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