# Foreign Direct Investment:

## The Determinants of FDI Inflow in ASEAN Member States

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## Introduction

Recently, the emerging market of Southeast Asian nations has grown rapidly. Foreign Direct Investment (FDI) has played an important role in the growth and influence of these nations. FDI, described as the ownership or controlling interest of a business in one country by a firm in a different country has boomed in the past 20 years (1997-2017), specifically in Singapore and Indonesia. The amount of FDI Inflow a nation receives is a key driver to higher economic growth and greater influence in the overall global market. FDI Inflows also increase the wealth and prosperity in a nation through creation of jobs.

Knowledge of what overseas multinational enterprises look for when determining what nation to invest in is beneficial for the governments and the businesses of the Southeast Asian nations. This research will examine what economic indicators are determinants of FDI and the extent to which each indicator effects the FDI Inflow. These indicators will include GDP per Capita, CPI, unemployment rate, interest rates, and foreign exchange rates.

## Literature Review

**Sjöholm (2013):** Nations with high exports of raw materials and natural resources with a large coastline receive higher FDI inflows than nations without these variables.

**Bano and Tabbado (2015):** Higher FDI inflows of a given nation receives plays an important role in the amount of FDI outflow from the given nation.

**Ritchie (2002):** A developing country with a slightly higher skilled labor force receives higher rates of FDI inflows due to higher human capital quantities.

**Diaconu (2014):** MNE's will take advantage of post-recession economies with a low cost of labor leading to a rapid recovery and growth period.

**Ma and Ratcliff (2018):** Export mix has a large impact in FDI inflows and outflows between two nations with similar markets and industries to find economies of scale.

## Research Question

**Does GDP per Capita have the most influence in determining FDI Inflow in Southeast Asian nations?**

**Hypothesis: GDP per Capita has a positive impact on the amount of FDI Inflow.**

## Variables

| Variable | Definition |
|---|---|
| LogFDI_Inflows | The investment or ownership of a business in a foreign country by a Multinational Enterprise |
| Loggdp_pc | The log of the GDP of a country by its population, using a PPP basis |
| Consumer Price Index (CPI) | Consumer Price Index is an average measure of consumer basket goods and services every year |
| Real_intrate1 | The country's interest rate after taking into account inflation |
| Unemployment Rate (unemploy1) | The unemployment rate measures the population of unemployed workers in the total labor force |
| Logexchange | The log of the official currency exchange rate of home currency needed to buy 1 USD |

## Empirical Framework


$$LogFDI\_Inflow_{it} = \beta 0 + \beta_1 loggdp\_pc_{it} + \beta_2 CPI_{it} + \beta_3 real\_intrate1_{it} + \beta_4 unemploy1_{it} + \beta_5 logexchange_{it} + \varepsilon$$

Foreign Direct Investment inflow is analyzed in a four different regressions. These regressions are panel data, Time Fixed Effects, Country Fixed Effects, and Time/Country Fixed Effects. The data consists of 8 countries over a period of 20 years, from 1997-2017. The key variable for this research is the GDP per Capita of each nation. To support the hypothesis, GDP per Capita must have a positive and significant relationship with FDI inflows. The other variables are possible economic determinants that impact the quantity of FDI inflow a Southeast Asian nation receives.

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| VARIABLES | Panel | Time FE | Country FE | Time/Country FE |
| | | | | |
| loggdp_pc | 0.355** | 0.347** | 0.406 | 0.014 |
| | [0.137] | [0.140] | [0.609] | [1.002] |
| CPI | 0.008* | 0.002 | 0.011 | 0.020 |
| | [0.005] | [0.009] | [0.013] | [0.017] |
| real_intrate1 | -0.001 | 0.016 | 0.004 | 0.024 |
| | [0.020] | [0.024] | [0.020] | [0.025] |
| unemploy1 | -0.011 | -0.014 | -0.004 | -0.007 |
| | [0.016] | [0.017] | [0.017] | [0.018] |
| logexchange | -0.002 | -0.011 | -0.656 | -1.175* |
| | [0.050] | [0.051] | [0.523] | [0.706] |

Standard errors in brackets
*** p<0.01, ** p<0.05, * p<0.1

Sources: Bloomberg Terminal, CEIC Data

## Conclusion & Further Research

*Conclusion:*

- A 1% increase in GDP per Capita within Southeast Asian nations is associated with a 35.5% increase in FDI Inflows from 1997 to 2017
- Race and household education are economic determinants that significantly affect a Southeast Asian nation's Foreign Direct Investment in the past 20 years.

*Further Research:*

- Examine more in depth economic determinants of FDI Inflow
- Explore how FDI Outflow from Southeast Asian nations effect the amount of FDI Inflow the nations receive