

Select FDI Determinants in ASEAN-5 and their Implications on ASEAN Integration

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Abstract

Southeast Asia is on the brink of history: By the end of 2015, the region will undertake its boldest step yet and start becoming an integrated economic community, opening up financial and trade markets in the 10-member bloc. The free flow of goods and capital will also allow the entry of more investors. However, with only a few months left before the integration, the preparedness of some members of the Association of Southeast Asian Nations (ASEAN) has been put into question. This study examines the five biggest members of ASEAN—Indonesia, Malaysia, the Philippines, Singapore and Thailand—on the basis of the factors that attract foreign direct investment (FDI) to their territories. The panel data analysis shows that two variables—corruption perception and the size of the labor force—have a significant impact on FDI in the region, highlighting both the regional group’s strengths and weaknesses, which could present both as challenges and opportunities in the upcoming integration.

KEYWORDS: ASEAN, foreign direct investment, labor force, corruption perception

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Introduction

Background of the Study

In 2013, foreign direct investments (FDI) to developing countries returned to pre-global financial crisis levels, rising 11% year-on-year to \$759 billion, a new record high, and accounted for 52% of aggregate FDI flows that year.¹ Of the total FDI, \$406 billion flowed to developing Asia, including South East Asia. FDI has been a key part of that region, especially during the 1997 Asian financial crisis, when the "Washington Consensus" was first prescribed by multilateral lenders such as the International Monetary Fund.² The prescription—a set of policies directed toward liberalizing the market—was rooted in the belief that more FDI creates jobs that help boost economic activity, promote economic development and, in the process, eradicate poverty.³ While past studies have also shown negative consequences stemming from FDI, these have been far outweighed by the benefits, as proven by how countries have continuously taken steps to reduce barriers to investment. Investors, on the other hand, have been picky and wise, differentiating FDI destinations, which in turn results in large discrepancies in FDI generation.

Take the Association of South East Asian Nations (ASEAN) as an example. The 10-member bloc is a mixed bag in terms of FDI accumulation. At the top of the ladder is Singapore, which accumulated \$837.65 billion in FDI as of 2013.⁴ Far at the bottom is Myanmar, which despite slowly opening up itself to the world, was only able to lure \$14.17 billion in FDI during the same period. In the middle, Malaysia, the Philippines and Thailand all garnered varying amounts of FDI with some countries trailing the others by billions of dollars. The Philippines, for instance, ranks sixth in the region in FDI, falling behind Vietnam. The former, however, only generated \$32.547 billion in FDI, not even half of Vietnam's \$81.702 billion. In the same way, Vietnam's FDI pales in comparison with that of Malaysia, which placed fourth in FDI at \$144.705 billion. The discrepancies in FDI inflows toward these economies reflect how investors differentiate among countries and help explain the number of previous studies that have examined FDI determinants.⁵

This comes at a time when the region is preparing to integrate and remove trade and investment barriers and become an "economic community" by the end of

2015. While the bloc sees it as an opportunity to facilitate intra-ASEAN trade and investment, nothing stops other nations from looking at ASEAN members individually as the world economy becomes more globalized. The region itself realizes the need to become “fully integrated in the global economy” and as such, the success of the ASEAN Economic Community does not only rely on the recognition of each member-country's interests, but also on the rest of the world.

Toward this end, this paper aims to look outside the upcoming integration, and to examine the biggest and original ASEAN members—namely Indonesia, Malaysia, the Philippines, Thailand and Singapore—in the context of their individual characteristics and how they would continue to play their part in attracting foreign investments to their territories. The paper studies select FDI determinants in the so-called ASEAN-5, which collectively accounted for more than half of the total FDI inflows to South East Asia in 2013.⁶ It asks how varying economic, political and social factors across the membership affect FDI inflows and how these differences could affect policies in these countries and facilitate investor “differentiation” outside the ASEAN Economic Community.⁷

The rest of the study is arranged as follows: Section 2 will provide more information on the challenges faced by the ASEAN integration as well as how these relate to FDI generation. The same section will provide the theoretical foundations for the study. Section 3 will define the parameters of the variables to be used on the regression analysis. Section 4 will provide statistical results, while the last section will contain the study's conclusions.

Literature and Scope

ASEAN Integration amid Differentiation

Prospects for the ASEAN Economic Community have been mostly positive. As it is, the ASEAN integration aims to achieve four goals, namely the creation of a single market and production base, increased competitiveness, the promotion of equitable economic development, and integration of the ASEAN to the global economy. The promised benefits of integration have driven member countries to reconcile their differences and address the challenges they pose for themselves.

These include gaps in infrastructure among member-states, large differences on tax rates on certain inputs, and the absence of a common tariff policy. Former ASEAN Secretary-General Ong Keng Yong emphasizes that within the 10 member-states, the region suffers from a “development gap” in which one member’s stature in laws and regulations and over-all business environment tends to be more advanced or lag behind another.⁸ While these differences may indeed create an impact on the viability of the integration itself—Ong admits these challenges are unlikely to be overcome by 2020—it is also important to look at how these could impact on investor perception over the region.

Even before the integration can happen, “differentiation” in Asia has already taken place. Among ASEAN-5 members, for instance, differentiation is more evident during times of distress, such as in 2013 when the US Federal Reserve announced that it is getting ready to reduce the stimulus it is providing to the US economy.¹⁰ For years after the global financial crisis of 2008, the so-called quantitative easing program by the Fed did not only provide much-needed credit to the US, but also to the global economy. Hence, when the announcement came that it would soon be over, financial markets got roiled over but at different levels. The Philippine peso, for example, lost a tenth of its value versus the dollar, half of what the Indonesian rupiah lost (See Figure 2.1), but noticeably more than what the Singaporean dollar lost during the period.¹⁰

Two years after, the same story is noticeable after a drop in commodity prices and an economic slowdown in China fanned deflation fears. In particular, the Malaysian ringgit (9.8% down versus the dollar as of August) and Indonesian rupiah (8.4%) suffered declines “unseen since the Asian financial crisis,” while other ASEAN-5 units such as the Thai baht (6.4%) and the Philippine peso (2.2%) were reduced far less.¹¹ For some observers, this differentiation is more a product of local developments than external ones, pointing not only to “macroeconomic vulnerabilities” such as current account and budget deficits, but also to “political risk factors” such as a change in government or political issues such as corruption allegations made against Malaysian Prime Minister Najib Razak and the unfulfilled promise of Indonesian President Joko Widodo to upgrade the country’s infrastructure.¹² Despite these differences, ASEAN-5 countries all face similar problems ahead of the integration. The challenges

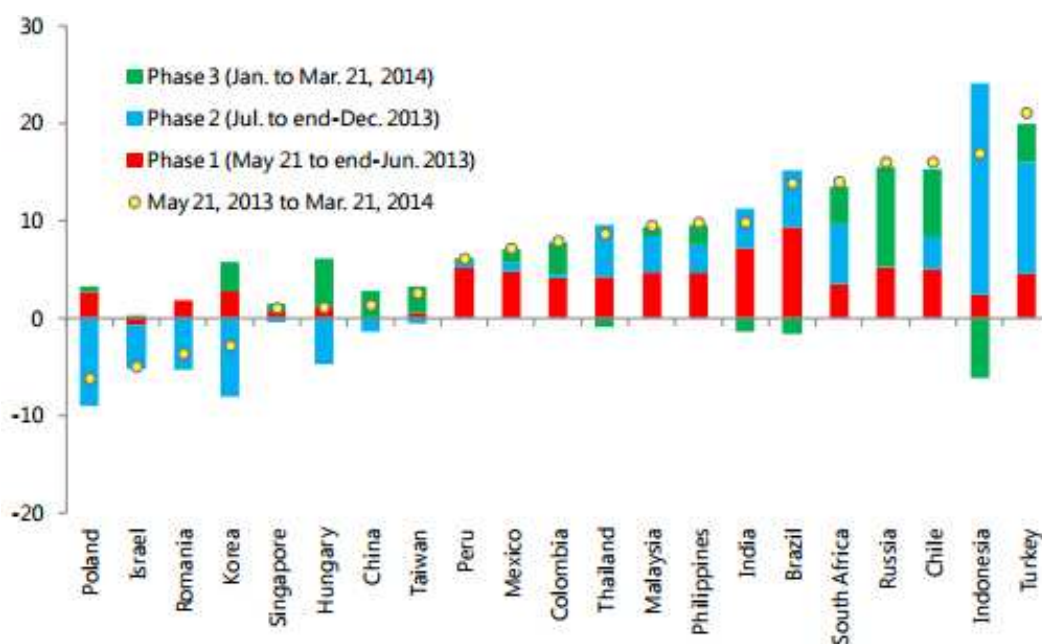


Figure 2.1: Foreign exchange rates (%change, "+"= depreciation)

for the developing region are huge, and around \$8 trillion will be needed over the next five years to address the region’s infrastructure woes.¹³ The “development gap” mentioned by the former ASEAN chief is also very evident among its largest members: Singapore’s GDP per capita is about 10 times that of the Philippines and of Thailand. Such challenges could only be solved by ensuring that capital remains available and by the look of things, investors are unlikely to take ASEAN—even after the integration—collectively; in fact they are potentially singling out countries, differentiating among them.

Capital inflows—not only intra-regional, but also global—need to be ensured if ASEAN-5 is to bridge its development gap, attach itself more to the global economy, and create a viable integration that will endure generations. This cannot come solely from an integrated market, and member-countries will have to look outward for other funding sources.

FDI: Benefits, Risks, and Drivers

The type of funding that is provided is another important factor, and one of the best sources of capital considered by governments for long-term development is FDI. FDI's benefits have been linked by many to economic development and prosperity, particularly with the experience of some Asian countries during the 1997 crisis. At that time, Singapore, South Korea, and Taiwan instituted market-driven reforms to allow foreign investors come onto their shores, own companies and funnel capital in. This eventually helped struggling governments cope with their stretched out balance sheets.¹⁴

Much has been attributed to FDI's multiplier effect: Its capacity to act as a financing bridge for deficit-ridden states, while at the same time providing avenues for technology and expertise transfer to local companies to boost competitiveness.¹⁵ This, in turn, paves the way for better and affordable services to the public, who are also bound to benefit from more employment opportunities brought about by relocating foreign companies.¹⁶ In the process, more jobs are expected to facilitate increased economic activity, which would then bring in more investments and enable the loop to continue (see Figure 2.1). The "virtuous cycle" of FDI is proven through the success of many countries, particularly those that survived the Asian financial crisis, such as that the IMF and the European Union continue to prescribe to open markets and competition as solutions to the present euro zone crisis.¹⁷ Furthermore, the reinforcing nature of FDI has put economies in a competition, proven by how governments have consistently tried to lure investments not only through better regulations and policies, but even through incentives with their own repercussions such as lowering tax incomes and market distortions.¹⁸ For them, all these proven benefits trump negative consequences, such as the "Dutch disease" phenomenon, as similarly laid out by previous research studies.

In a Dutch disease scenario, the country's trade sector suffers because of an overvalued exchange rate created by large amounts of FDI that entered the country to exploit its natural resources. A strong currency makes exports uncompetitive abroad and thus, other sectors such as manufacturing may be forced to cut back on production, resulting in lay-offs, which would then impact on the population's purchasing power. Dutch disease also creates a funding gap between sectors in such

a way that while the natural resource sector receives much of FDI, the concentration of foreign money denies other vital industries of much needed financing.

The continued adherence of many countries to market mechanisms proves that they still consider FDI to be beneficial rather than disadvantageous. Because of this, drivers of FDI have been extensively studied, while researchers have underscored

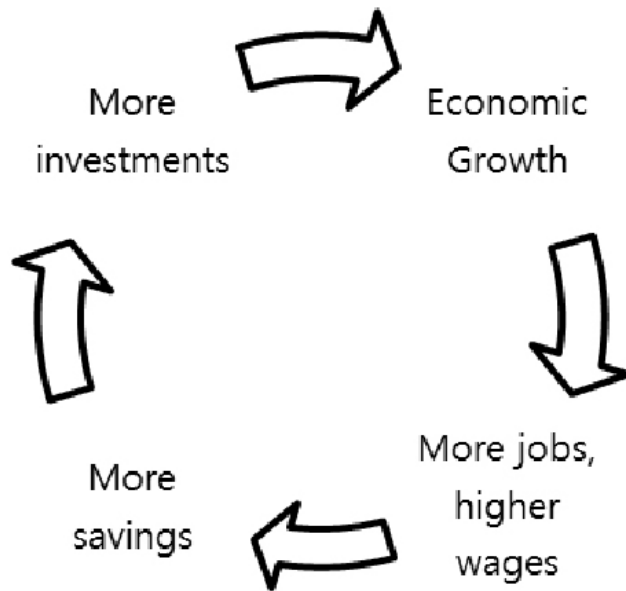


Figure 2.1: FDI "virtuous cycle"

varying factors that attract foreign investors to host countries. Some of them have identified economic factors such as economic growth, per capita income, inflation and foreign exchange.¹⁹ Others have focused on political factors such as corruption, regulatory processes, and rule of law,²⁰ while the rest looked at social factors such as demographics, literacy rate and even religion.²¹

Walsh and Yu, for their part, examined both economic and social variables to analyze different kinds of FDI in sectors such as agriculture and manufacturing.²² They discovered two things: one, both economic and social variables have different effects on FDI, and two, effects also vary depending on the type of investments involved. For instance, real effective exchange rates do not have much impact on mining, but may matter more to manufacturing since it is usually connected to the export industry. In the same way, a company looking to invest in the manufacturing sector may feel comfortable doing so despite slow growth, if it stands to benefit from a country's large demographics and low wages.²³ Meanwhile, investors may also shrug off strong economic expansion if they perceive that political risks such as corruption outweigh potential benefits from a large market.²⁴

The Eclectic Paradigm Theory

The Eclectic Paradigm Theory, also known as the OLI Model or the OLI Framework, partly explains the different investor considerations for placing money in one territory over the other. Formulated by John H. Dunning in the 1980s, the model pertains to three advantages that determine the flow of FDI: ownership advantages (O), location advantages (L), and internalization advantages (I). The theory emerged as a “catch-all” scheme for FDI.²⁵ The “O” advantage pertains to a multinational enterprise’s (MNEs) unique expertise, which it wants to reproduce globally. The likes of Apple and Samsung, and the products that they produce, are examples of this. On the other hand, the “I” advantage relates to the benefit that MNEs stand to gain should they decide to outsource or locate hubs in other countries to market their products and services. These two advantages, which both pertain to the characteristics held by investors, are considered together with the qualities of investment destinations available. The latter is what makes the “L” advantage.

Specifically, the “L” advantage examines host countries’ characteristics that may appeal to investors. This covers a number of FDI determinants, which are weighed by investors together with the “O” and “I” factors in making an investment decision. In ASEAN-5’s case, this highlights each country’s differences, which continue to be obvious despite the region’s efforts to integrate. The demographic advantages of the Philippines over Singapore and the manufacturing prowess of the latter, Malaysia, and Thailand over the rest of the region could work well for them to attract different types of FDI. Depending on a company’s needs, Dunning²⁶ argues that “firm-specific behavioral differences” are also considered and interplay with the three advantages O, L, and I included in the framework. For ASEAN-5, a number of different qualities, some of which have already been mentioned, exist. The challenge, therefore, is to be able to cover different segments, with respect to how these individual economies differ and how investors differentiate them from each other to date. In addition, the paper tries to balance economic, political, and social considerations, which foreign investors may examine under the OLI Framework in considering FDI placements.

To this end, the study chose five determinants—namely economic growth, inflation (GDP deflator), corruption, labor force and property rights. A detailed explanation of each variable is provided in the next section.

Definition of Terms

Economic growth

Gross domestic product (GDP) is one of the primary and most-trusted measures of economic activity being used. It shows the total value of products and services created in an economy. GDP growth, hence, is an indication of how much an economy develops and provides an indication of its over-all market size, a rather important determination under the OLI Framework if one would consider the potential earning capacity of marketing a particular product or service.²⁷ Simply put, this is important since investors always seek a profit, and a larger market size reinforces that.

Furthermore, other indicators are also highly dependent on GDP and GDP growth. For instance, determining per-capita income—or the share of wealth of everyone in an economy—is determined by dividing the population over economic size. In addition, however, GDP growth also reflects business activity, whose expansion—or contraction—correlates with that of per-capita income. Finally, GDP captures a wide range of economic activity, ranging from domestic demand to external demand through imports and exports, as well as capital inflow and outflow. Hence, this indicator provides an over-all gauge of economic performance that has been proven by various studies to have a positive significant impact on FDI.²⁸ For this study, data on real GDP growth from UNCTAD will be used.

As far as ASEAN is concerned, observers have pointed out how economic growth in the regional bloc has buoyed the global economy, especially after the global financial crisis. From 2015 to 2017, this is expected to continue, with the 10-member group projected to post an average growth rate of 5.06%—faster GDP growth than the 2.23% seen for high-income countries and the 3% for the entire global economy.²⁹ However, not only have the past few years been witness to ASEAN's increasing importance globally; they have also demonstrated the increasing interdependence among the member-countries themselves. In ASEAN-5, for instance, Singapore—the largest in the group—is seen to benefit from higher growth rates of Malaysia and Indonesia, where the latter countries' increase in GDP by 1% is likely to contribute as much as 0.31% to Singaporean economy. In turn, Thailand's

own GDP is projected to rise by 0.20% for every 1% in additional growth in the island city-state.³⁰ This interdependence is expected to strengthen more as the ASEAN integration creates a seamless environment for the movement of goods and services that will feed into each and every territory's GDP performance.

Inflation (GDP deflator)

The rise in consumer prices is another economic indicator closely watched by policymakers and the private sector. Most governments use the consumer price index (CPI) to measure how fast prices of basic goods and services rise at a particular time. For this study however, the World Bank definition of inflation (GDP deflator) is used to cover the rate of price change “in the economy as a whole.” Simply put, the difference between the CPI and inflation (GDP deflator) is that while the former only relies heavily on a survey of households, the latter considers other institutions such as businesses. The focus given to inflation is based on the idea that higher prices tend to be avoided by investors due to their impact on the purchase of raw materials or a country's cost of living. This, in turn, could have a downside impact on their profit margins. The negative significant relationship between inflation and FDI has been established in studies that, more often than not, have also examined GDP's effect—hence the counterbalancing effect on each other.³¹ For instance, a foreign company may decide against investing in a country with high GDP growth, but also with high inflation. Such an economic phenomenon called “overheating” is a sign that an economy is bound to slow down abruptly and experience a “hard landing” in the long run.

For the ASEAN-5, inflation dynamics have been mixed as a result of the variation of economies in the region. For example, the Philippines and Indonesia usually suffer from high inflation rates due to their large populations that fuel consumption. Singapore and Malaysia, on the other hand, tended to have a slower rise in prices, partly because of their export-driven economies. After the global financial crisis however, a surge in capital flows to Asia have put policymakers on guard against potential inflationary pressures that may emanate from the huge amounts of money flowing in.³² The ASEAN integration is expected to contribute to more capital flowing in and out of its member countries. While inflation has been less of a concern

since last year because of the weak global economy, the ASEAN, in further opening up its borders, should watch against the “imported inflation” that may affect its over-all economic performance.

The research will source inflation (GDP deflator) data from the World Bank World Development Indicators.

Public corruption

Corruption is not limited to the government. It may manifest itself in various forms and avenues such as the private sector. However, it has been conventionally understood that when one talks about corruption, he or she usually pertains to corruption in the bureaucracy or to those people in power. Public corruption is defined as “the private wealth-seeking behavior of someone who represents the state and public authority. It is the misuse of public resources by public officials for private gains.”³³ While the definition clearly limits the source of corruption to be tackled by the study, it still covers a wide array of activities that may be classified as “corrupt,” including bribery, fraud, and graft.³⁴ Nonetheless, previous research’s findings on corruption’s impact on FDI have been mixed. For instance, while Egger and Winner³⁵ stress how corruption could put a dent in FDI because investors find it “costly” to bribe people to enter the market, Henisz finds corruption to be useful against bureaucratic red tape, as demonstrated in China’s experience.³⁶ This only bolsters the need to revisit previous studies and refresh literature in this area. It also shows the multi-faceted character of corruption, and constrains this study to find a suitable gauge with which to capture investors’ corruption concerns. For this purpose, data from the “Freedom from Corruption” sub-index provided by the annual Economic Freedom Index by the Heritage Foundation will be used. Figures from the sub-index were garnered using the Transparency International’s Corruption Perceptions Index (CPI), a yearly survey that measures how corrupt a country is based on perceptions of various stakeholders such as businessmen and scholars.

Three of the 10 most corrupt leaders in history have come from the ASEAN region.³⁷ Mohamed Suharto of Indonesia and Ferdinand Marcos Sr. and Joseph Estrada of the Philippines were known to have embezzled billions in wealth when they were in power. Thailand, on the other hand, suffered from a number of political

crises that saw revolts and military coups overthrowing governments due to allegations of fraud, the latest of which was that of Yingluck Shinawatra, daughter of the deposed leader Thaksin Shinawatra. At the other end, Singapore has consistently ranked among the cleanest governments on the CPI report. Since foreign investors usually observe from the outside, the mixed corruption perceptions of ASEAN countries creates a possible source of investor differentiation once the integration commences, and thus may further explain the differences in FDI levels.

Labor force

ASEAN's economic strength is also heavily hinged on its growing population, particularly the middle-class, based on the assumption that young populations are good markets for profit-seeking businesses. However, this is not only true for boosting consumption but also for providing workers to the factories and offices that FDI may bring to the country. The region has the third largest labor force in the world, just behind India and China.³⁸ The positive relationship between having a young working population and FDI has been tackled in previous studies such as those by Zhao as well as by Walsh and Yu, who concluded that MNCs are attracted to a young workforce which presents a good supply of labor, allowing them to boost production and services.³⁹ For this study, labor force data from UNCTAD will be used. The multilateral agency defines a labor force as those people aged 15 years old and up who are "economically active" (based on the definitions of the International Labor Organization). It is for this reason that labor force is preferred over entire population data: It accounts for the active contribution of the so-called "demographic dividend" in ASEAN.

Property rights

The capacity of companies to own private property protected and secured under the law is an important consideration for foreign companies planning to establish a long-term undertaking abroad. In addition, legal impediments such as inefficient enforcement of contracts as well as regulatory uncertainties like constant changing of rules may only add to concerns of foreign investors who may fear not being able to get their money back.⁴⁰ The "Property Rights" sub-index in the Economic

Freedom Index captures this data for the study. The rankings define property rights as “the degree to which a country’s laws protect private property rights and the degree to which its government enforces those laws.” In addition, the best score under this sub-index is said to have the following: Private property “guaranteed” by the government; a court system that enforces contracts “efficiently and quickly”; a justice system that punishes those “who unlawfully confiscates private property”; and the absence of corruption or expropriation. The scope of the variable’s definition, hence, reflects the kinds of institutions that dispense the rule of law and the regulatory powers vested upon them.

In ASEAN’s case, Buracom argues the need for the region to not only develop good policies to attract investors, but also to “appropriate” institutions that will ensure the effectiveness of state rules and regulations once the integration happens.⁴¹ In the 10-member bloc, diversity in policies and institutions could not be more evident. Myanmar’s relatively late opening of its economic sectors is proof of this,⁴² but within the bigger and older members of the group, the ASEAN-5 also demonstrates huge gaps in terms of property rights. One example is how they treat foreign investors doing business in their territories. The Philippines, Thailand, and Indonesia continue to restrict some of their industries to local participants only, while Singapore and Malaysia have almost completely liberalized the same. Observers stress the need for some economies to remove ownership barriers to attract more FDI, while others have pointed out that better regulations and elimination of bureaucratic red tape could substitute for this.⁴³ This kind of discrepancy may also contribute to the divergence in FDI among member-countries and will need to be examined in the context of the upcoming integration.

Hypothesis Building

The independent variables examined in this study feed into the locational advantages considered by investors on making investment decisions. Hence, any changes in the performance of the regressors could contribute to changes in FDI levels in the ASEAN-5. These are equally weighed against other factors in the OLI Framework, namely ownership and internalization advantages, as well as firm-specific, individual investment strategies and differences in how they would want

to achieve their long-term objectives and goals. Since the study's focus is on how host countries can do their part in swaying investment decisions, the following hypotheses on the relationship of FDI with independent variables are drawn, considering both the OLI Model and related literature:

- On economic growth: Higher GDP growth is likely to translate to higher FDI.
- On inflation (GDP deflator): Higher inflation tends to reduce FDI.
- On public corruption: Higher corruption perception tends to decrease FDI.
- On labor force: The existence of a larger labor force is likely to attract more FDI.
- On property rights: The perception that investor rights will be secure and protected tends to increase FDI.

Analysis

Data Collection

The study uses a total of six variables with the FDI as the dependent variable. The five independent variables are economic growth, inflation (GDP deflator), labor force, corruption perception and property rights. For FDI, stock figures denominated in billion US dollars are utilized. Stock FDI measures the amount of FDI accumulated through time. Using this data instead of the yearly FDI inflows allows the study to control for changes that could occur through time. Furthermore, it reflects how changes in the regressors are likely to affect the amount of FDI in the host country. Data is sourced from the UNCTAD database.

As for the independent variables, growth is represented by real GDP growth, which indicates the annual average percentage change based on constant prices in each country's national currency. Labor force includes people age 15 and up, regardless if they have jobs or not. Data sets for both indicators are also garnered through UNCTAD. Inflation (GDP deflator), meanwhile, is sourced from the World Bank's World Development Indicators. Lastly, property rights and corruption perception, as proxy to corruption, are secured from the annual rankings of the Heritage Foundation. Both indicators use a scale of 0 to 100, with the latter being the best.

A total of 95 observations are included in the study (see Figure 4.1, Appendix). The time period covered is from 1995 to 2013, or 18 years.

Variable	Obs	Mean	Std. Dev.	Min	Max
FDI	95	109.8198	161.8769	6.73	837.652
Economic growth*	94	4.626383	3.883815	-13.13	14.78
Inflation					
(GDP deflator)	95	5.513579	8.725466	-5.99	75.27
Corruption perception	95	45.65263	26.36316	10	94
Property rights	95	57.89474	21.98378	30	90
Labor force	95	38.16506	37.32831	1.74	123.441

*- Unavailable: Indonesia (2003)

Figure 4.1: Descriptive statistics

Regression Results

The study examined the different determinants of FDI in the five biggest economies of ASEAN using a panel data analysis.^{*} It tackled five different independent variables representing economic (GDP growth, inflation (GDP deflator)), political (corruption perception, property rights) and social (labor force). The analysis shows that among all variables, only corruption perception and labor force have significant correlation to FDI flows (see results in Figure 4.2). The rest of the variables (GDP growth, inflation and property rights) were not seen to have any considerable effect on FDI in the five economies included in the study. In terms of regression diagnostics, since the research used a random effects model, test for multicollinearity is unnecessary. The same is true for auto-correlation tests.

^{*} Hausman test: $p = 0.0852$. Results of $p < 0.05$ qualifies the use of fixed effects model. Otherwise, use random effects model.

FDI	Coef.	Std. Err.	z	P>z	[95% Conf. Interval]	
Economic growth	-4.153601	3.83261	-1.08	0.278	-11.66538	3.358176
Inflation (GDP deflator)	-2.384886	1.873184	-1.27	0.203	-6.056	.286488
Corruption perception	5.625641**	.9556591	5.89	0.000	3.752583	7.498698
Property rights	-.8937734	1.10747	-0.81	0.420	-3.064375	1.276828
Labor force	1.570468**	.5515246	2.85	0.004	.4894995	2.651436
_cons	-121.9863	64.92299	-1.88	0.060	-249.233	5.260447

**Significance level: $p < 0.01$
R-squared: Within: 0.0307 Between: 0.9606 Over-all: 0.4255

Figure 4.2: Results of random effects panel analysis

Discussion

Results suggest a number of things. First, they reinforce previous studies' findings that show the perceived "cleanliness" of the state as a strong factor that determines potential foreign investors.⁴⁴ The strong positive correlation between the FDI and the CPI also shows that, ceteris paribus, foreign investments tend to increase with a country's score in CPI. It further reflects that an increase of one point on the scale of 0 to 100 may attract an additional \$5.63 billion in FDI. It bears noting that the results confirm the study's hypothesis. The study assumed that higher corruption perception tends to reduce FDI. In the variable used, an improvement in the score actually reflects a "cleaner" government, hence justifying the positive significant correlation to FDI.

Another significant relationship could be seen between FDI and labor force. The positive correlation between the two reinforces previous studies that concluded that a large pool of workers stimulates FDI. This could be explained by two things: First, the existence of an active and young labor market gives a foreign investor potential workers for his or her company, which in turn could drive production levels. Second, an earning labor force also serves as a bankable consumption base that could pay for products and services produced by the company. Both large production and consumption fuel demand and help increase profit margins for corporations. Based on the results, an additional 1 million people in the workforce

tends to increase FDI inflow by \$1.57 billion, assuming all other things are equal. As a region, ASEAN enjoys the so-called “demographic dividend” of having young demographics that spend and work at the same time. Collectively, the ASEAN-5, plus Vietnam, are projected to increase their population by 1.14% until 2015, while their labor force is estimated to grow by 1.58%, both of which are “higher than the corresponding over-all Asian averages.”⁴⁵

Other regressors—namely economic growth, inflation (GDP deflator) and property rights—all posted insignificant negative relationships with FDI. The results for inflation (GDP deflator) were as expected and are backed by previous studies. For GDP growth, a negative relationship may be explained by the interplay between inflation and economic growth. A growing economy may tend to increase prices and thus, may dampen investor confidence in the long run. In the ASEAN-5, such phenomenon is present in Indonesia, which continues to suffer from high consumer prices with its fast economic growth. As for property rights, the negative relationship underscores the relatively young institutions in the region when compared with those in developed markets. The negative link could also be connected to the institutional disparities in ASEAN-5 countries and reinforces the need for harmonization, not only in the reduction of tariffs or removal of barriers to trade and investments as envisioned by the integration, but more so in the institutions in charge of ensuring that the individual states’ regulatory environment makes continuous efforts to create an investor-friendly business setting.

Conclusion and Policy Implications

This study examines the determinants of FDI to ASEAN-5 economies in a bid to determine how they could impact on the planned integration by the end of 2015. It looks at potential economic, political, social and institutional variables that could help explain what drives FDI. Using random effects panel regression, the research has found that the perception of how clean the government is (corruption perception) and the size of the labor force, *ceteris paribus*, tend to have significant correlation or impact FDI on the five biggest economies in the bloc. Other variables of GDP growth, inflation (GDP deflator) and property rights did not indicate any significant

effect. Nonetheless, the results reflect the primary considerations and concerns of foreign investors in ASEAN. The huge size of the labor force in the region has long been tagged as an advantage, while concerns over public corruption amid past controversies in some member-countries have also been a major concern for years. This is not to say, of course, that investors do not look at other factors such as growth, inflation and property rights, in making FDI decisions. As the OLI Framework has argued, it is not only locational advantages but also specific long-term management strategies foreign investors may take note of that form part of the rest of the model.

To a certain extent, the results also highlight the diversity of ASEAN economies, which could explain investor differentiation during specific episodes of distress. However, while such diversity has been celebrated, it also poses a threat to the integration inasmuch as some members may be left out of potential gains the integration is said to bring, such as a freer flow of capital and, thus, of FDI.

On the flipside, the differentiation also offers an opportunity for ASEAN.⁴⁶ For instance, since it shows that labor force makes a significant positive effect on FDI, Singapore—which suffers from an aging population—may benefit from the integration through easier labor mobility. In turn, developing countries such as the Philippines and Indonesia may likewise learn from some of the technological best practices of the likes of Singapore.

At the end of the day, however, all benefits will only be recognized if countries make the necessary adjustments to harmonize their policies ahead of the integration. Institutionalization of these policies is also important. At the very least, the persistent concern about corruption in the ASEAN-5 shows that for the past two decades, regulations and institutions established to tackle this crime have been weak or ineffective. This highlights the need for governments to not only consistently explore other ways and avenues of promoting good governance, but also to ensure that good policies are retained and executed through time, while bad ones are replaced.

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Appendix

INDONESIA						
Year	FDI stock inflow (in billion US\$)	Real GDP growth (in %)	Inflation (GDP deflator) (in %)	Freedom from Corruption (0-100 range)	Property Rights (0-100 range)	Labor Force (in millions)
1995	20.626	8.22	9.7	10	50	88.921
1996	26.871	7.82	8.85	10	50	91.775
1997	31.6	4.7	12.57	19	50	91.693
1998	31.393	-13.13	75.27	27	50	92.835
1999	29.555	1	14.16	27	50	98.168
2000	25.06	4.94	20.45	20	50	99.931
2001	15.203	3.65	14.3	17	30	101.623
2002	7.117	4.47	5.9	17	30	103.156
2003	10.328		5.49	19	30	105.014
2004	15.858	5.03	8.55	19	30	107.139
2005	41.187	5.69	14.33	19	30	109.287
2006	54.534	5.5	14.09	20	30	110.974
2007	79.927	6.35	11.26	22	30	112.689
2008	72.228	6.01	18.15	24	30	114.368
2009	108.796	4.63	8.27	23	30	116.447
2010	160.735	6.22	8.26	26	30	118.023
2011	184.804	6.49	8.07	28	30	119.909
2012	211.9	6.23	4.38	28	30	121.706
2013	230.344	5.7	4.35	30	30	123.441

Select FDI Determinants in ASEAN-5 And Their Implications on ASEAN Integration

MALAYSIA						
Year	FDI stock inflow (in billion US\$)	Real GDP growth (in %)	Inflation (GDP deflator) (in %)	Freedom from Corruption (0-100 range)	Property Rights (0-100 range)	Labor Force (in millions)
1995	28.731	9.83	3.63	70	70	8.303
1996	36.028	10	3.68	70	70	8.564
1997	42.351	7.32	3.48	53	70	8.841
1998	45.065	-7.36	8.5	53	70	9.133
1999	48.96	6.14	0.04	50	70	9.424
2000	52.747	8.86	8.86	53	70	9.89
2001	33.972	0.52	-1.58	51	50	10.119
2002	37.542	5.39	3.13	48	50	10.342
2003	41.188	5.79	3.3	50	50	10.556
2004	43.047	6.78	6.01	49	50	10.759
2005	44.46	5.33	8.86	52	50	10.957
2006	53.71	5.58	3.98	50	50	11.158
2007	75.763	6.3	4.88	51	50	11.354
2008	73.601	4.83	10.39	50	50	11.549
2009	78.995	-1.51	-5.99	51	50	11.743
2010	101.62	7.42	4.12	51	55	11.977
2011	115.064	5.13	5.52	45	50	12.233
2012	132.4	5.64	0.74	44	50	12.48
2013	144.705	4	-0.09	43	55	12.722

PHILIPPINES						
Year	FDI stock inflow (in billion US\$)	Real GDP growth (in %)	Inflation (GDP deflator) (in %)	Freedom from Corruption (0-100 range)	Property Rights (0-100 range)	Labor Force (in millions)
1995	6.73	4.68	7.55	10	50	27.702
1996	8.25	5.85	7.66	30	70	28.413
1997	9.499	5.19	6.22	28	70	29.126
1998	11.251	-0.58	22.38	27	70	30.139
1999	12.429	3.08	6.59	31	70	30.817
2000	13.762	4.41	5.71	33	70	30.971
2001	10.385	2.89	5.55	36	50	33.07
2002	11.565	3.65	4.16	28	50	33.316
2003	11.411	4.97	3.2	29	50	34.424
2004	12.737	6.7	5.52	26	30	34.919
2005	14.978	4.78	5.83	25	30	34.845
2006	16.914	5.24	4.95	26	30	35.142
2007	20.463	6.62	3.09	25	30	35.601
2008	21.746	4.15	7.55	25	30	36.74
2009	22.931	1.15	2.77	25	30	37.795
2010	25.896	7.63	4.22	23	30	38.719
2011	25.48	3.64	4.02	24	30	39.716
2012	28.687	6.81	1.9	24	30	40.691
2013	32.547	7	1.98	26	30	41.664

Select FDI Determinants in ASEAN-5 And Their Implications on ASEAN Integration

SINGAPORE						
Year	FDI stock inflow (in billion US\$)	Real GDP growth (in %)	Inflation (GDP deflator) (in %)	Freedom from Corruption (0-100 range)	Property Rights (0-100 range)	Labor Force (in millions)
1995	65.644	7.28	3.29	90	90	1.74
1996	89.494	7.63	1.47	90	90	1.825
1997	74.468	8.51	1.04	93	90	1.851
1998	86.84	-2.17	-1.36	88	90	1.894
1999	102.533	6.2	-3.9	87	90	1.955
2000	110.57	9.04	3.74	91	90	2.012
2001	138.775	-1.15	-2.24	91	90	2.054
2002	161.226	4.2	-1.25	91	90	2.09
2003	183.623	4.58	-1.71	92	90	2.128
2004	215.97	9.16	4.25	93	90	2.177
2005	237.009	7.37	2.23	94	90	2.244
2006	313.184	8.62	1.72	93	90	2.342
2007	420.877	9.02	5.86	94	90	2.455
2008	455.03	1.75	-1.49	94	90	2.585
2009	503.136	-0.79	3.52	93	90	2.695
2010	622.507	14.78	-0.05	92	90	2.809
2011	673.033	5.16	0.83	92	90	2.872
2012	796.559	1.32	1.47	93	90	2.917
2013	837.652	3	0.12	92	90	2.948

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THAILAND						
Year	FDI stock inflow (in billion US\$)	Real GDP growth (in %)	Inflation (GDP deflator) (in %)	Freedom from Corruption (0-100 range)	Property Rights (0-100 range)	Labor Force (in millions)
1995	17.684	8.14	5.59	70	90	32.068
1996	19.706	5.66	4.01	70	90	32.858
1997	13.333	-2.76	4.06	28	90	33.618
1998	25.481	-7.65	9.24	33	70	33.825
1999	31.114	4.58	-4.04	31	70	33.89
2000	31.118	4.52	1.35	30	70	34.824
2001	34.754	3.39	2.07	32	70	35.618
2002	39.919	6.19	0.82	32	70	36.135
2003	51.176	7.18	1.33	32	70	36.626
2004	55.149	6.32	3.13	32	50	37.352
2005	62.833	4.18	4.49	33	50	37.886
2006	80.542	4.94	5.24	36	50	37.995
2007	96.562	5.45	3.45	38	50	38.824
2008	96.643	1.67	3.93	36	50	39.156
2009	110.07	-0.91	1.95	33	50	38.637
2010	142.498	7.33	3.66	35	45	39.404
2011	159.343	0.34	4.23	34	45	39.783
2012	185.689	6.43	0.24	35	45	40.13
2013	185.463	3	2.79	34	45	40.446

Sources: UNCTAD, Heritage Foundation's Economic Freedom Index, World Bank's World Development Indicators