



## **THE EFFECTS OF CORRUPTION ON FDI INFLOW: THE CASE IN ASEAN FROM 1996 TO 2011**

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# Introduction

- + *ASEAN is now a popular destination for FDI flow:*
  - + Peculiar advantages: low labor, raw material costs, impressive economic growth, and many ***preferential policies*** to fascinate foreign investors.
    - . These will diminish once the economies move to a higher level;
    - . The cost to implement the preferential policies is considerable; and
    - . It is also difficult to sustain these preferences in the long term.
  - E.g., Vietnam: facing new challenges in attracting investment since the labor cost and commodity price surge.
  - => **The strategy of FDI attraction that based on the advantage of low costs will lose effectiveness in the long term.**
- + *Thus, attracting investment based on the improvements of investment environment through a high quality of human capital, modern infrastructure, and effective institutions need to be paid more attention.*

# Objectives

The research questions:

- + Is the negative relationship between FDI inflow and Corruption level applied for ASEAN countries? And,
- + Whether the corruption level could influence to the shift of FDI inflow from sector to sector? *CORR is a determinant?*
- + Especially, to what extent the proportion of FDI in Agriculture/Manufacturing/Service sector; and total FDI inflow of host country change once the control of corruption level changes?

# Literature review

Douglass North (1990):

- The development of a national wealth is not primarily due to its rich natural resources or diligence of large numbers of workers;
- *It is mainly stimulated by the binding elements within management institutions;*
- Good institutions create a better economic environment likely to encourage innovation, boost production and sustainable growth.

**Corruption: “*the abuse of entrusted power for private gain*”** (Transparency International).

→ as one aspect of the institution that affects the investment climate and attracts FDI inflow.

**Negative impacts of corruption on FDI flows:**

Mauro (1995), (Tanzi and Davoodi, 1997), (Bardhan, 1997), Wei (2000a: 1), (Wei, 2000b), Patrick Tingvall, Gustavsson (2010), etc.

**Some papers failed to find the evidence of corruption and FDI relation:** (Abeb and Davoodi, 2000; Akçay, 2001), Al-Sadig (2009) .

**Only a few studies focus on the influence of factors on attracting FDI in the countries in Southeast Asia:** Normaz (2009), and Tajul and Hussin (2010).

# Data

- + We employ the database from ASEAN Statistics.
- + The established dataset of FDI inflow for ASEAN countries from 1996 to 2011, including **9 ASEAN countries**: excepting Myanmar and East Timor due to data limitation.
- + The data of FDI by economic sector: *Agriculture; Manufacturing; and Service.*
  - ⇒ To be applied for the period of 1999-2005.

# Methodology



- + New dependent variable - FDI inflow by economic sector - will provides a new deep insight of the relationship between corruption and the restructure of FDI by sector from source countries to ASEAN countries.
- + Two relationships (*FDI inflow and corruption; and FDI by economic sector and corruption*) were estimated through 3 equations:
  - OLS model:  $\ln(Y)_{it} = \beta_0 + \beta_1 \text{Control of Corruption}_{it} + \beta_S X_{i,t-1} + u_{i,t}$  (1)
  - Specification model with FE and macro-indicators as control variables:

$$\ln(Y)_{it} = \beta_0 + \beta_1 \text{Control of Corruption}_{it} + \beta_S X_{i,t-1} + \gamma D_i + \delta T_t + u_{i,t} \quad (2)$$

- INST is added into FE model to clarify the effectiveness of the institution and control of corruption:

$$\ln(Y)_{it} = \beta_0 + \beta_1 \text{Control of Corruption}_{it} + \beta_2 \text{INST}_{it} + \beta_S X_{i,t-1} + \gamma D_i + \delta T_t + u_{i,t} \quad (3)$$



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## Methodology (cont.)



endent variables used in all 3 models:

$\frac{FDI_{inflow}}{totalPopulation}$ ; and  $\frac{FDI_{bysector}}{FDI_{inflow}}$

on	Description	Control for	Expected sign
	GDP per Capita	Market size	(+)
	GDP growth	Market size	(+)
	Population growth	Market potential	(+)
	Secondary school enrolment	Quality of human capital	(+)
	Inflation	Economic stability	(-)
	FDI stocks as a percentage of GDP in the host country	Agglomeration effect	(+)
	The government effectiveness	Effectiveness of Institution	(+)
	Rule of law	Quality of institution	(+)
	Political Stability, No Violence	Political Stability	(+)
	Openness	Freedom of trade and service	(+)