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: $\ln(\mathrm{Y})_{\mathrm{it}} = \beta_0 + \boldsymbol{\beta_1} Control\ of\ Corruption_{it} + \beta_S X_{i,t-1} + u_{i,t}$ (1)

- Specification model with FE and macro-indicators as control variables:

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

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

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

Methodology (cont.)

ıdent variables used in all 3 models:

$$\frac{FDI_{inflow}}{talPopulation}; \quad and \quad \frac{FDI_{bysector}}{FDI_{inflow}}$$

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	(+)