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Determinants of Foreign Direct Investment in ASEAN-5: Economic, Institutional, and Social Factors

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ABSTRACT

In the era of globalization, foreign direct investment (FDI) plays a crucial role in supporting economic growth and stability in developing countries. The ASEAN region strategically attracts FDI due to its diverse economic, social, and institutional characteristics. This study aims to analyze the influence of internal and external factors on FDI in ASEAN-5 countries from 2003 to 2023. The variables studied include corruption, trade openness, Human Development Index (HDI), and economic growth. Using the panel data regression method with a fixed effect model approach, the analysis results show that economic growth positively and significantly affects FDI. In contrast, trade openness shows a significant negative impact. Conversely, the corruption perception index and HDI show no significant effect. These findings emphasize the importance of economic stability and institutional quality in creating a competitive and sustainable investment climate in the ASEAN region.

Keywords: Corruption, Economic Growth, Foreign Direct Investment, Human Development Index, Trade Openness

JEL Classification: D73, O47, F21, I15, F13

INTRODUCTION

Nowadays, the term globalization is increasingly heard, indicating the increasingly close interconnectedness between countries around the world. This growing interconnectedness among countries has encouraged extensive economic cooperation across both the real and financial sectors. In this context, investment emerges as a crucial element in navigating the dynamics of economic globalization. Among the various forms of investment, Foreign Direct Investment (FDI) stands out for its substantial flow of funds. Multinational companies channel FDI to expand their business operations beyond their borders, while individuals and corporations seek to establish ownership stakes or exert influence in enterprises abroad (Cristina et al., 2023).

ASEAN countries are experiencing relatively rapid growth in Foreign Direct Investment (FDI), which can help them in global economic activities (Ramdan et al., 2020). Driven by open economic policies, regional integration, labor cost competitiveness, and human resources, FDI has grown rapidly (Tkalenko et al., 2022). ASEAN is becoming an attractive investment destination for multinational companies due to its broad market access, developed infrastructure, and investment incentives offered by governments (Fuddin & Maulidiyah, 2024; OECD, 2023). All countries that refer to an open economic system participate in trade and finance. Trade openness is seen as important in meeting domestic needs and trying to increase economic growth, so that countries work together (Fitriani et al., 2021). Trade openness is defined as the share of total exports and imports in GDP, so that it can reflect the outward-oriented trade policy of an economy (Rehman et al., 2021). Openness to trade can facilitate access to modern technology, promote competition, and increase economic growth, especially in developing countries.

Open trade significantly increases FDI in ASEAN by creating a more attractive business environment for foreign investors (Wardani, 2024) . With free trade policies such as the ASEAN Free Trade Area (AFTA) agreement and various trade agreements with global partners, countries in the region offer wider market access and the elimination of tariffs and non-tariff barriers for investors (OECD, 2023). Theoretically, openness to trade, openness to the economy (trade) reflected in international trade, will increase the prosperity of a country, through the theory of comparative advantage, as the specialization of each country's products will increase the volume of trade (Nova Anom et al., 2019).

The effectiveness of FDI is also inseparable from the quality of human resources reflected in the Human Development Index (HDI). The Human Development Index is an indicator that measures the quality of human life (Gulo et al., 2023). This indicator covers economic living standards, education, and health. The existence of a collective human development index can measure the success of development in a region and assess the ability of its human resources. Foreign investors look for countries with skilled, productive, and cost-competitive labor to support their business operations (Mayeko, 2024). Countries like Singapore, Malaysia, and the Philippines have succeeded in attracting FDI in the technology and services sectors because they have well-educated human resources, mastery of digital skills, and international languages. On the other hand, countries like Indonesia, Vietnam, and Thailand have attracted investment in the manufacturing sector because of their large workforce and relatively low costs (Kirana, 2022; Zalva et al., 2023).

Corruption is a multifaceted phenomenon characterized by the abuse of power for personal gain and manifests in various forms such as bribery, embezzlement, and colonization. Corruption is a form of dishonesty or crime by individuals or organizations in authority to obtain illicit benefits or abuse power for personal gain (Hadi Mousavi, 2020). This can involve bribery, influence peddling, and embezzlement, often undermining politics and democracy. Ing & Magiera (2015); Marjanović et al. (2024) despite having a large and skilled workforce, if the bureaucratic system is not transparent, licensing is difficult, and legal certainty is weak, investors tend to look for other countries with a more stable business environment. On the other hand, countries with clear regulations, a strong legal system, and practical anti-corruption efforts, such as Singapore and Malaysia, are more attractive to FDI because they provide guarantees for business continuity (Priyadi et al., 2024). ASEAN countries with high levels of corruption often have difficulty in utilizing their human resource potential to attract investment (Kurniasih et al., 2023; Muliani et al., 2024). Therefore, improving the quality of human resources must be accompanied by clean and transparent governance reform.

With clean and transparent governance, economic growth in a country will also increase. Economic growth is a picture of economic development in a specific period compared to the previous period, and this development is expressed in the form of a percentage (Muqorrobin & Soejoto, 2017). Economic growth is a key indicator that reflects a country's economic performance over a specific period. Stable and sustainable economic growth is the main goal for every country because it is directly related to improving people's welfare, expanding employment opportunities, and national competitiveness (Junaheni Afifah & Mirna Nur Alia Abdullah, 2024). In the context of developing countries, efforts to encourage economic growth are a challenge in themselves because various domestic and global factors influence them. Increased economic growth in a country can reflect increased foreign direct investment entering the country, bringing increased investment, technological progress, and innovation. This can also affect a country's GDP growth. The Association of Southeast Asian Nations (ASEAN-5), with member countries Indonesia, Malaysia, Singapore, Thailand, and the Philippines, aims to spur economic growth and social welfare (Firmansyah & Mu'ammal, 2023).

Research conducted by Sumesara (2020) shows that gross domestic product (GDP) is the total market value of all final goods and services produced in a country in a given year, calculated using nominal estimates at market or official government exchange rates. According to the World Bank, GDP can represent the amount of value added by all producers in a country. This added value is the value of the producer's gross output minus the value of semi-finished goods and services consumed in production before considering the consumption of fixed capital. GDP is a key indicator that reflects the economic conditions of a country because it measures the total output of production activities in a region during a specific period. This indicator also plays an important role in formulating economic development strategies and policies Hua (2022). The endogenous growth theory, which is the theory of the development of the Solow model, explains that the existence of FDI can provide a positive contribution to GDP in a country. GDP has a complex and varied relationship to Foreign Direct Investment. This aligns with research conducted by Anh et al. (2024), indicating a positive and significant relationship between Gross Domestic Product and Foreign Direct Investment in various income groups. This also applies in most countries, regardless of their level of development, showing a positive relationship between GDP growth and FDI. Research from Anwar et al. (2023) examined the relationship between GDP growth and FDI in ASEAN-5 countries, but factors such as corruption, trade openness, or HDI were not considered. Similarly, research by Zahroo (2023) highlights the influence of trade openness and political instability on FDI but does not include variables such as HDI or corruption. Other studies, such as those by Karim et al. (2018), found that corruption and market size significantly affect FDI inflows in ASEAN-5 countries. However, this study did not simultaneously integrate variables such as HDI or trade openness.

Research on the determinants of FDI in ASEAN countries has been widely conducted, but most previous studies have limitations in the scope of variables, time, and methodological approach. Therefore, this study comprehensively combines four main variables, namely corruption, trade openness, human development index, and economic growth, to analyze their effects on FDI in ASEAN-5 through a simultaneous approach. In contrast, previous studies only focused on one or two factors. In addition, the data span of this study is quite long, so this study better captures the long-term dynamics and structural effects of the variables tested, especially during the global crisis and the COVID-19 pandemic. Thus, this study aims to analyze the influence of internal and external factors on Foreign Direct Investment (FDI) in ASEAN-5 countries, namely Indonesia, Malaysia, Singapore, Thailand, and the Philippines, from 2003 to 2023. Specifically, this study aims to examine the extent to which the level of corruption, trade openness, Human Development Index (HDI), and economic growth contribute to the inflow of FDI into each country. By including these variables simultaneously, this study is expected to provide a more comprehensive picture of the main factors influencing foreign investors' decisions to invest in the ASEAN-5 region. The results of this study are also expected to provide empirical contributions and policy implications for the government and stakeholders in improving the competitive investment climate in the Southeast Asia region.

METHOD

This type of research is quantitative research using secondary data sourced from the World Bank, Transparency International, and the United National Development Program. Secondary data is needed as primary data that meets each variable's criteria to assess the variables' impact. The variables used in this study are corruption, trade openness, human resources, and economic growth as independent variables and Foreign Direct Investment (FDI) as the dependent variable. The sample of this study includes ASEAN-5 countries, including Indonesia, Malaysia, Singapore, the Philippines, and Thailand. This study uses the panel data regression method because the data used is panel. This analysis method is also in accordance with the purpose of the study to see the influence of the variables used on FDI partially and simultaneously in each ASEAN-5 country in the long term. The model used in this research is as follows:

$$\mathrm{FDI}_{it} = \alpha i + \beta_1 \mathrm{CRP}_{it} + \beta_2 \mathrm{TO}_{it} + \beta_3 \mathrm{HDI}_{it} + \beta_4 \mathrm{EG}_{it} + \epsilon \mathrm{it} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

Where:

FDI : Foreign Direct Investment
CRP : Corruption
TO : Trade Openness
HDI : Human Development Index
EG : Economic Growth

The operational definition of the variables in this study is described in the following table:

Table 1. Operational Variable

Variable	Remarks	Source
Foreign Direct Investment (FDI)	Net Inflows (% of GDP)	World Bank
Corruption (CRP)	Score	Transparency International
Trade Openness (TO)	Trade (% of GDP)	World Bank
Human Development Index (HDI)	Percent (%)	United National Development Program
Economic Growth (EG)	GDP Growth (Annual %)	World Bank

Source: World Bank, Transparency International, United National Development Program

The dependent variable, FDI, is measured through net foreign direct investment inflows as a percentage of GDP, taken from the World Bank. Corruption is measured through the corruption perception index, which reflects the level of corruption in a country, with data obtained from Transparency International. Trade openness shows the level of involvement of a country in international trade and is measured using an index obtained from the World Bank. Furthermore, the Human Development Index (HDI) is measured by indicators of health, education, and standard of living, which reflect the community's quality of life, with data obtained from the United Nations Development Programme. Meanwhile, economic growth is measured by annual GDP growth (%), which reflects a country's economic performance and is influenced by factors such as household consumption, investment, government spending, trade balance, and productivity generated. This data is also obtained from the World Bank.

RESULT

This section presents the study's empirical findings based on the estimation results of the panel data regression models. The analysis includes the best model test and panel regression results. The results aim to provide insights into how corruption, trade openness, human development, and economic growth influence foreign direct investment inflows in ASEAN-5 countries over the study period. In the first test, the best model test from the panel data will be carried out to determine which model will be selected for panel regression.

Table 2. Best Model Test

Effect Test	Prob	Result
Chow Test	0.0000	Fix Effect Model
Hausman Test	0.0000	Fix Effect Model

Source: Data Processed, 2025

In this study, two stages of testing were carried out to determine the most appropriate estimation model, namely the Chow Test and the Hausman Test. The results of the Chow Test show a probability value of 0.0000 < 5% significance value, so it is concluded that the Fixed Effect model is the right model, so the Lagrange Multiplier (LM) test does not need to be carried out. Furthermore, the Hausman Test also shows a probability value of 0.0000 <5% significance value, which indicates that the Fixed Effect Model is the right model. Thus, based on the two tests, the best model used in this study is the Fixed Effect Model.

Table 3. Panel Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob
C	14.68713	4.048078	3.628174	0.0005
CRP	-1.020206	0.629624	-1.620342	0.1084
TO	-0.057661	0.013093	-4.403956	0.0000
HDI	4.499231	2.999080	1.500204	0.1368
EG	0.355918	0.089678	3.968841	0.0001
Adjusted R-squared	0.902414			
Prob(F-statistic)	0.000000			

Source: Data Processed, 2025

Table 3 shows that corruption has a negative and insignificant effect on FDI, with a prob value of 0.1084 > 0.05. The trade openness variable has a negative and significant effect on FDI, with a prob value of 0.0000 < 0.05. The HDI variable shows a positive but insignificant effect on Foreign Direct Investment (FDI) with a prob value of 0.1368 > 0.05. The Economic Growth variable also has a significant positive effect on FDI, as indicated by a probability value of <0.05. In addition, the overall model is significant with a Prob p-value (F-statistic) of 0.0000.

DISCUSSION

Based on the results of this study, this can occur because it creates uncertainty, increases business costs, and weakens investor confidence in economic stability, as well as the legal certainty of a country. This study's results align with research conducted by Lestari et al. (2022), which states that corruption and financial development have a negative impact on FDI inflows. Thus, increased corruption can reduce FDI despite financial development. Ferreira et al. (2023) The Corruption Perception Index (CPI) was also examined, and no significant effect of corruption on FDI inflows from 2012 to 2019 was found. Corruption control can encourage FDI, but the overall impact of corruption is insignificant (Zangina & Hassan, 2020). This result also aligns with the Sands the Wheels Hypothesis theory, which states that corruption makes a country less attractive to investors because they face the risk of legal uncertainty, informal costs, and potential abuse of power by public officials.

This results align with the theory of structural imbalances, which states that in some developing country contexts. However, trade policies are open, structural barriers such as bureaucratic inefficiency, complex investment regulations, and inadequate infrastructure can hinder the potential for FDI inflows. This indicates that even though a country has a high level of trade openness, other factors such as the quality of human resources, political and economic stability, and domestic investment policies can be more dominant in attracting foreign investors. In addition, the trade liberalization process is also believed to increase competition, which ultimately encourages innovation and production efficiency, making FDI recipient countries more attractive in the eyes of global investors. The results of this study are supported by Le et al. (2023), which explains that trade openness can encourage increased FDI flows because it provides easy access to broader markets and reduces the cost of exporting goods and services. Another study by Rehman et al. (2021) also explains that reducing trade barriers allows foreign investors to enter the domestic market more efficiently, increasing the potential for investment profits.

The relationship between HDI and FDI is influenced by many factors, including the country's absorption capacity, development of financial institutions, quality of governance, and motivation of foreign investor strategies (Kanwanye et al., 2021). The results of this study are supported by research from Sarker & Khan (2020), which explains that the negative impact of FDI on economic growth can occur when a target country cannot absorb and utilize the new technology that comes with FDI. In addition, the lack of consensus on the impact of human capital development on FDI inflows can hinder further growth. Srivastava & Talwar (2020) Also states that HDI did not significantly impact FDI in 30 countries. This suggests that improvements in human development do not directly attract more foreign investment. This finding is also in line with the human capital theory, which emphasizes that investment in the quality of human resources can increase productivity, create social stability, and expand market potential, all of which are important factors in foreign investment decisions.

This result indicates that the higher the economic growth rate of a country, the greater the interest of foreign investors in investing their capital. Stable and continuously developing economic conditions provide a positive signal for foreign investors regarding profit and investment security prospects. The results of this study are supported by research from Okegbe (2019), which states that FDI can catalyze economic growth by providing capital, technology, and expertise to the target country. This provision can stimulate productivity and innovation, and thus encourage economic expansion. Another study from Elian et al., (2024) Economic growth has consistently been shown to positively affect FDI inflows in both the short and long term, as evidenced in the BRICS countries and other regions. This is also in line with classical economic theory, which states that high economic growth is the leading indicator of macroeconomic stability, increasing purchasing power, and considerable market potential, thus creating opportunities for investors.

CONCLUSION

Based on the results of research conducted on five ASEAN countries (Indonesia, Malaysia, Singapore, Thailand, and the Philippines) during the period 2003 to 2023, it can be concluded that the influence of internal and external factors on Foreign Direct Investment (FDI) shows complex and interrelated dynamics. The findings show that the trade openness variable has a negative and significant effect on FDI, indicating that even though a country has a high degree of trade openness, it does not guarantee an increase in foreign investment inflows. On the contrary, economic growth is proven to have a positive and significant effect on FDI, confirming that high economic stability and growth provide a positive signal for foreign investors regarding profit prospects, investment security, and growing market potential. Meanwhile, the corruption variable shows a negative but insignificant effect on FDI. Although statistically insignificant, the direction of its influence still reflects the tendency that corruption creates legal uncertainty, increases informal costs, and weakens investor confidence in the stability and reliability of a country's investment environment. On the other hand, the Human Development Index (HDI) shows a positive but insignificant effect on FDI, indicating that improving the quality of human resources, reflected by improvements in the education, health, and income sectors, has great potential in increasing the attractiveness of foreign investment. However, the effect is not yet statistically strong in the short term.

Overall, the results of this study underline that in the ASEAN-5 region, economic growth is the most consistent and significant factor in attracting foreign direct investment. Meanwhile, the effects of trade openness, corruption, and HDI on FDI are contextual and influenced by the structural characteristics of each country. Therefore, policies that only focus on trade liberalization or the development of macro indicators alone are not necessarily effective in increasing FDI flows. A more comprehensive and integrated approach is needed, including institutional reform, improving the quality of human resources, and creating a stable economic and political climate to create sustainable investment competitiveness in the Southeast Asian region.

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