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**THE DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN
ASIAN COUNTRIES**

NUR HIDAYAH BINTI SUKERY



**MASTER OF SCIENCE FINANCE
UNIVERSITI UTARA MALAYSIA
2017**

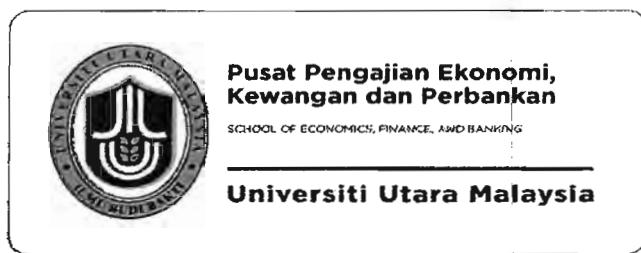
**THE DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN
ASIAN COUNTRIES**

By

NUR HIDAYAH BINTI SUKERY



**Research Paper Submitted to
School of Economics, Finance and Banking,
Universiti Utara Malaysia,
in Partial Fulfillment of the Requirement for the
Master of Science (MSc) Finance**



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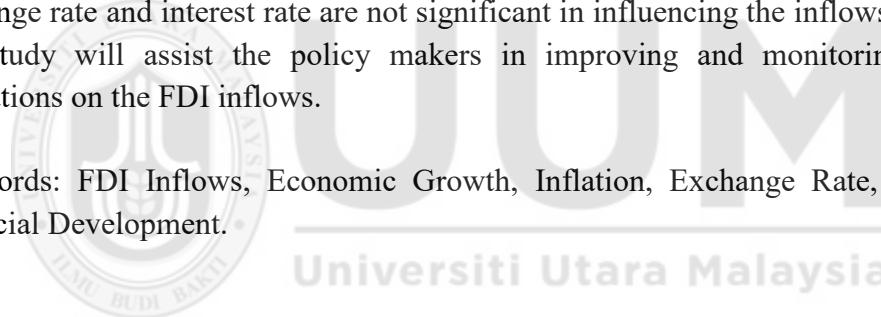
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ABSTRACT

FDI is an investment from the international organizations and individual investors in the host countries to acquire the control on the invested firms and return. In theory, FDI stimulates economic development and improve the well-being of societies. The objectives of this study are to determine the effect of economic growth, inflation, exchange rate, interest rate and financial development on FDI inflows in 26 Asian countries for the duration of 16 years (2000 to 2015). The dependent variable is the FDI net inflows meanwhile the independent variables are economic growth, inflation, exchange rate, interest rate and financial development. This study finds a positive link between financial development and FDI inflows in the 26 Asian countries. This implies that a sound financial development would allow easier accessibility to the international financial market and thereby attract more foreign investors in the domestic financial system, hence improves the FDI inflows in the host country. Moreover, inflation has found to accelerate the FDI inflows while higher economic growth dampens the level of international funds flowing into the host countries. In addition, this study discovers that exchange rate and interest rate are not significant in influencing the inflows of FDI. Thus, this study will assist the policy makers in improving and monitoring the current regulations on the FDI inflows.

Keywords: FDI Inflows, Economic Growth, Inflation, Exchange Rate, Interest Rate, Financial Development.



ABSTRAK

FDI adalah pelaburan dari organisasi antarabangsa dan pelabur individu di negara tuan rumah untuk memperoleh kawalan ke atas syarikat yang dilaburkan dan pulangan. Secara teori, FDI merangsang pembangunan ekonomi dan meningkatkan kesejahteraan masyarakat. Objektif kajian ini adalah untuk mengkaji kesan pertumbuhan ekonomi, inflasi, kadar pertukaran, kadar faedah dan pembangunan kewangan ke atas aliran masuk FDI di 26 negara Asia untuk tempoh 16 tahun (2000 hingga 2015). Pemboleh ubah bergantung adalah aliran masuk bersih FDI sementara itu pembolehubah bebas adalah pertumbuhan ekonomi, inflasi, kadar pertukaran, kadar faedah dan pembangunan kewangan. Kajian ini mendapati hubungan positif antara pembangunan kewangan dan aliran masuk FDI di 26 negara Asia. Ini menunjukkan bahawa pembangunan kewangan yang kukuh akan mempermudahkan akses ke pasaran kewangan antarabangsa dan dengan itu menarik lebih banyak pelabur asing dalam sistem kewangan domestik dan meningkatkan aliran masuk FDI di negara tuan rumah. Tambahan lagi, inflasi telah ditemui dapat mempercepat aliran masuk FDI sementara pertumbuhan ekonomi yang tinggi dapat melemahkan tahap dana antarabangsa yang mengalir ke negara-negara tuan rumah. Di samping itu, kajian ini mendapati bahawa kadar pertukaran dan kadar faedah bukanlah penentu aliran masuk FDI. Oleh itu, kajian ini akan membantu penggubal undang undang dalam memantau undang undang semasa mengenai aliran masuk FDI.

Kata kunci: Aliran masuk FDI, Pertumbuhan Ekonomi, Inflasi, Kadar Pertukaran, Kadar Faedah, Pembangunan Kewangan.

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LIST OF ABBREVIATIONS

Abbreviation	Meaning
FDI	= Foreign Direct Investment
GDP	= Gross Domestic Product
CPI	= Consumer Price Index
INF	= Inflation
OER	= Official Exchange Rate
INT	= Interest Rate
FD	= Financial Development
USD	= United States Dollar



CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Foreign direct investment (FDI) is defined as an objective of creating a lasting interest by a direct investor in an enterprise and economy which is other than investor's country. The lasting interest here indicates that a long term relationship exists between direct investors and the enterprise with the significant degree of influence on the enterprise's management (OECD, 2008). FDI is considered to be an important economic factor because it stimulates economic development and improve the well-being of societies (Ali & Hussain, 2017; Pandya & Sisombat, 2017; Zekarias, 2016). Moreover, with a proper policy framework, FDI can offer financial stability to the participated countries because it is considered to be an important driver of the international economic integration (OECD Report, 2008).

Main components of FDI are debt instruments and equity. Debt instruments include bonds, non-participating preference shares, promissory notes, debentures and commercial paper. In addition, the instruments also comprise of other tradable non-equity securities, trade credit, accounts payable, account receivable, deposits and loans. Meanwhile, equity includes preferred shares, common shares, reinvestment of earnings, reserves and capital contributions.

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APPENDIX A

. tset code year

panel variable: code, 1 to 26

time variable: year, 2000 to 2015

. regress fdi x1lngdp x2inf x3lnexch x4int x5fd

Source	SS	df	MS	Number of obs	=	408
Model	7833.5971	5	1566.71942	F(5, 402)	=	38.33
Residual	16432.9127	402	40.8778922	Prob > F	=	0.0000
Total	24266.5098	407	59.6228742	R-squared	=	0.3228

Adj R-squared = 0.3144
Root MSE = 6.3936

Fdi	Coef.	Std. Err.	t	P> t	[95% Conf.	Interval]
x1lngdp	-1.456677	.2251071	-6.47	0.000	-1.899211	-1.014143
x2inf	.2143021	.0778971	2.75	0.006	.0611655	.3674388
x3lnexch	-.1234209	.1295968	-0.95	0.341	-.3781929	.1313511
x4int	.1405599	.0773918	1.82	0.070	-.0115833	.2927031
x5fd	.1376796	.0102809	13.39	0.000	.1174684	.1578907
_cons	30.74979	5.717277	5.38	0.000	19.51029	41.98928

. vif

Variable	VIF	1/VIF
x4int	3.04	0.328663
x1lngdp	2.39	0.418200
x5fd	1.98	0.506005
x3lnexch	1.47	0.678888
x2inf	1.45	0.691354
Mean VIF	2.07	

. xtreg fdi x1lngdp x2inf x3lnexch x4int x5fd, fe

Fixed-effects (within) regression

Group variable (i): code

Number of obs = 408

Number of groups = 26

R-sq: within = 0.0881
between = 0.0336
overall = 0.0401

Obs per group: min = 14
avg = 15.7
max = 16

corr(u_i, Xb) = -0.3035

F(5,377) = 7.29
Prob > F = 0.0000

fdi	Coef.	Std. Err.	t	P> t	[95% Conf.	Interval]
x1lngdp	.359351	.513003	0.70	0.484	-.6493546	1.368057

x2inf	.2141691	.0641365	3.34	0.001	.088059	.3402792
x3lnexch	-.2913752	1.950436	-0.15	0.881	-4.126472	3.543721
x4int	-.2782739	.0928809	-3.00	0.003	-.4609034	-.0956444
x5fd	.0318463	.0190046	1.68	0.095	-.005522	.0692145
_cons	-2.893277	13.76661	-0.21	0.834	-29.96223	24.17567
<hr/>						
sigma_u	6.5547743					
sigma_e	4.5269241					
rho	.67706188	(fraction of variance due to u_i)				

F test that all u_i=0: F(25, 377) = 17.00 Prob > F = 0.0000

. xttest3

Modified Wald test for groupwise heteroskedasticity
in fixed effect regression model

H0: sigma(i)^2 = sigma^2 for all i

chi2 (26) = 1.3e+05
Prob>chi2 = 0.0000

. xtserial fdi x1lndgdp x2inf x3lnexch x4int x5fd

Wooldridge test for autocorrelation in panel data
H0: no first order autocorrelation

F(1, 25) = 11.076
Prob > F = 0.0027

. regress fdi x1lndgdp x2inf x3lnexch x4int x5fd, robust cluster (code)

Regression with robust standard errors

Number of obs = 408
F(5, 25) = 2.45
Prob > F = 0.061
R-squared = 0.3228
Root MSE = 6.3936

Number of clusters (code) = 26

Fdi	Coef.	Robust	Std. Err.	t	P> t	[95% Conf.	Interval]
<hr/>							
x1lndgdp	-1.456677	.531753	-2.74	0.011	-2.551843	-.3615116	
x2inf	.2143021	.1182261	1.81	0.082	-.029189	.4577933	
x3lnexch	-.1234209	.3012653	-0.41	0.686	-.7438884	.4970465	
x4int	.1405599	.1404546	1.00	0.327	-.1487118	.4298316	
x5fd	.1376796	.0510741	2.70	0.012	.0324905	.2428686	
_cons	30.74979	12.05566	2.55	0.017	5.920688	55.57889	

APPENDIX B

Descriptive Statistics

Variable	Mean	Minimum	Maximum	Standard Deviation	N
FDI (%)	5.03	-4.70	58.51	7.69	413
GDP (USD billion)	55,300	43.90	1,110,000	148,000	416
Inflation (%)	4.57	-18.11	38.60	4.87	413
Exchange Rate (LCU/USD)	1,190.27	0.27	21,697.57	3,815.55	416
Interest Rate (%)	10.86	1.14	51.90	7.15	413
Financial Development (%)	61.91	3.76	233.21	43.29	414

APPENDIX C

Universiti Utara Malaysia

Correlation Analysis

	Y=FDI	X1=GDP	X2=CPI	X3=OER	X4=INT	X5=FD
FDI	1.0000					
GDP	-0.0509	1.0000				
CPI	0.0016	-0.2424	1.0000			
OER	-0.1151	0.0949	0.3004	1.0000		
INT	-0.0514	-0.6245	0.5321	0.3731	1.0000	
FD	0.3920	0.6192	-0.3736	-0.1527	-0.6374	1.0000