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Foreign Direct Invesment Flows in OIC Country

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Abstract: Investment is one of the funding needed by all countries to develop manufacturing and the economy. This study aims to examine the factors affecting the foreign direct investment flow among OIC countries. In order to achieve the goal, the authors use quantitative research methods using a regression test of data panels on the secondary data that has been collected. Panel data for the period 2012-2018 are used. The results showed that inflation and political stability have a significant and positive impact on FDI's entry. Meanwhile, corruption variables have a negative not significant effect on FDI and economic growth variables have a positive effect but not significant in FDI's entry in OIC Country. This research examines simultaneously the factors that determine FDI flow in OIC Country. This Paper provides value for policymakers in OIC Country recognized the need for outside capital as one of fund for the public. As well as consider the investor takes the decision in investing his funds especially in Asian countries member of Islamic Cooperation (OIC).
Keywords: corruption, FDI, economic growth, inflation, politics.

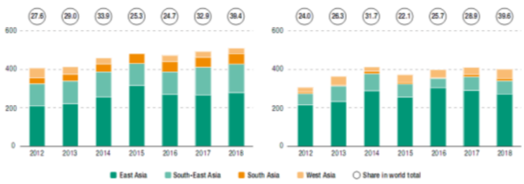
Abstrak: *Investasi merupakan salah satu sumber pendanaan yang dibutuhkan semua negara untuk membangun manufaktur dan perekonomian. Adapun tujuan dari penulisan paper ini adalah untuk menguji faktor apa saja yang mempengaruhi investasi langsung luar negeri di negara-negara OIC. Dalam rangka untuk mencapai tujuan, penulis menggunakan metode penelitian kuantitatif menggunakan uji regresi data panel pada data sekunder yang telah dikumpulkan. Data panel yang digunakan adalah periode 2012-2018.*
Hasil penelitian menunjukkan bahwasanya inflasi dan stabilitas politik menimbulkan dampak positif yang signifikan bagi arus masuknya investasi langsung luar negeri. Sementara itu, variabel korupsi berpengaruh negatif namun tidak signifikan terhadap investasi langsung luar negeri serta variabel pertumbuhan ekonomi berpengaruh positif tetapi tidak signifikan pada masuknya investasi langsung luar negeri di negara Organisasi Kerjasama Islam.
Paper ini memberikan nilai bagi pembuat kebijakan di Negara OKI mengakui kebutuhan modal luar sebagai salah satu dana untuk publik. Serta pertimbangan investor mengambil keputusan dalam menginvestasikan dananya terutama di negara-negara Asia anggota Kerjasama Islam (OKI).
Kata Kunci*: Korupsi, FDI, pertumbuhan ekonomi, Inflasi, politik.*

1. Introduction

Investment is one of the main players in driving the nation's economy, because with large capital it will expand production capacity and increase national income as well as create new jobs. An increase in investment will trigger an increase in economic growth because an increase in investment indicates an increase in investment. There is no single country economic growth in the world apart from the role of investment, because when investment in a country experiences a shock, it will have a stronger domino effect on its national income.

Investment drives the domestic economy in developed and developing countries, both direct investment (FDI) and indirectly. Direct investment will be used in the real sector, while indirect investment will be in the stock and bond markets or sukuk. Some researchers consider foreign direct investment to be far more beneficial than portfolios. This is because the effects of FDI in the form of capital, transfer of knowledge and technology can truly be felt by the state.

Conceptually, the interest or choice of investors to invest in the form of FDI compared to other forms of investment in a country is influenced by the conditions of the FDI recipient country as well as the conditions and strategies of the foreign investors themselves. For host countries, FDI plays a very important role as a foreign exchange enhancer aimed at economic development in that country.

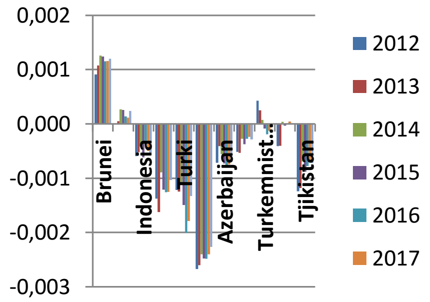


Source: World Investment Report

Figure 1.1
Inflow And Outflow FDI In Asian Continent Countries

FDI inflows to developing countries have increased, where Asia is the region that is the largest recipient of FDI compared to other regions, although there are also countries that are included in the least development category. The fast economic growth in Asia is the main drawer of FDI inflows into the region, this is related to the motive for expanding the target market as well as due to the large area and large population. This can be seen in Figure 1.1 where each year Asian countries show an increasing trend of FDI inflows to their countries.

Apart from economic stability, political stability deserves attention. Political stability is closely related to the government system, self-government has the most important role in attracting foreign investors. Due to its important role, the government should formulate policies that support the creation of a conducive investment climate. In policy making, of course, it cannot be separated from the role of political members as members of the state legislature. The following is data on political stability in Asian countries.



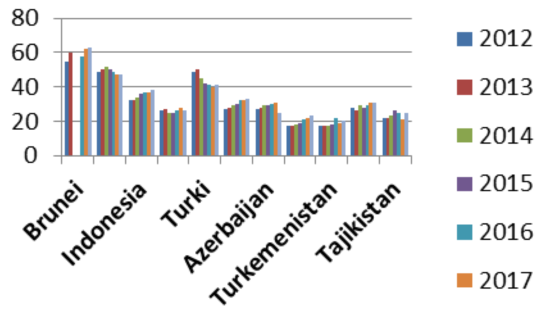
Source: World Bank Processed Data

Figure 1.2
Political Stability of Countries in the Asian Continent of OIC Members

Figure 1.2 shows the development of political stability which continues to fluctuate and there are shocks. Brunei Darussalam has a high level of stability followed by Malaysia. This is inseparable from the form of government in force in the country, namely the royal system still thickens. Overall, the data illustrates that developments in political stability in OIC countries on the Asian continent do not always coincide with an increase in foreign direct investment. This is an interesting gap phenomenon in research. Where a country with a high level of political stability is less able to attract foreign investors to invest, such as in Brunei Darussalam and Malaysia. Even in the 2016 worldbank data, FDI flows to Brunei showed a negative figure.

General corruption is seen by economists and international organizations as a challenge in today's modern society. This is because corruption can hinder economic growth and prosperity with market distortions that will reduce investment flows, including those from abroad. Corruption occurs because the perpetrators have misguided thoughts on the principles of honesty and trustworthiness. Thus, not only against morality in general, corruption is also against religion, that is, non-confrontational resistance.

In Islam, the principle of moderation (wasathiyah) is another face of justice. Doing something less (taqshir / tafrith) cannot be called justice, nor is doing something excessively (ifrath).



Source: Transparancy Index

Figure 1.3
Stability of State Corruption in the Asian Continent of OIC Members

The score data from the transparency index above fluctuated from 2012-2018. The higher the perception score of corruption indicates that the level of corruption in a country is getting better and decreasing. If connected with FDI data, a country with a corruption perception score such as Turkmenistan is actually able to attract investors to invest their capital, this is certainly different from the theoretical knowledge that the author knows, namely the lower the awareness of corruption, the lower the inflow of FDI.

Investors' interest in investing in a country is influenced by several macroeconomic fundamentals, such as inflation. Where inflation causes people's purchasing power to decline due to rising prices that occur. The very high inflation rate also increases the risk of business failure, ultimately making domestic investment less attractive. However, in certain circumstances inflation can also provide insights if the economy in a country is stable enough so that it is feasible to obtain foreign capital. Therefore, the aim of this research is to examine what factors influence the outflow of foreign investment in OIC member countries in Asia.

Further exploration of what factors are considered by foreign investors to invest in OIC countries, there have been several previous studies. (Papaconstantinou & Tzagkanos, 2013) examined the consequences of bureaucracy and corruption on the economic growth of the Greek state. Their study shows the negative impact of bureaucracy and corruption on economic growth. Research conducted by Castro & Nunes (2013) analyzed the impact of corruption on FDI inflows in 73 countries. Empirical findings based on test results suggest that countries with lower levels of corruption have larger FDI flows. The results also show that controlling corruption can be considered as a determinant of increasing the rate of FDI inflows.

Abdelaziz & Helmi (2017) conducted a study which analyzed the effect of corruption on foreign direct investment and economic growth in MENA countries. His paper shows that corruption is a serious hurdle to economic growth in MENA countries. Because it affects the activity and inflows of foreign direct investment. Besides, the research also reveals that political stability also appears to have a positive influence on economic growth.[1].

Quazi & Vemuri (2014) conducted a study on the analysis of the effects of corruption on FDI inflows in 53 countries on the African continent. Using a data set of 53 countries on the African continent to analyze the impact of corruption on FDI inflows. The empirical results show that corruption facilitates the inflow of FDI in Africa. The findings also show that the level of FDI is significantly influenced by market size, government effectiveness, infrastructure and economic freedom[2].

According to Fazira & Cahyadin (2018) observing data from 6 ASEAN member countries to determine the effect of interest rates, corruption indexes and economic growth on FDI inflows. Research shows evidence that economic growth and interest rates have a significant positive impact on FDI,

[1] Abdelaziz, H., & Helmi, H. (2017). Does corruption limit FDI and economic growth? Evidence from MENA countries". *International Journal of Emerging Markets*, 550-571.

[2] Quazi, R., & Vemuri, V. (2014). Impact of corruption on foreign direct investment in Africa. *International Buisness Research*, 1-10.

while the corruption index gives a significant negative result[3].

Research conducted by Anggraeni & Sulasmiyati (2019) conducted research on inflation and corruption in FDI inflows in ASEAN countries. The research findings state that the corruption index has a significant positive effect on FDI. Meanwhile, inflation does not significantly affect but has a positive relationship. Dewi & Cahyono (2016) also conducted research on FDI which used the independent variables of inflation and economic growth. The final result of the research shows that economic growth and inflation do not have a significant effect on FDI. Gani (2014) conducted research on the effect of political risk, GDP, GNP, exchange rate, wage costs on foreign direct investment. The results of his research found that the change of president in Indonesia for the 1994-2012 period had a significant positive effect on foreign investment. The facts show that when the president is changing, investors tend to hold back their funds so that FDI flows decrease, but in the following year FDI flows increase[4].

Wang & Li (2018) conducted research on factors that influence investment directly and indirectly from an institutional perspective. Where in this study comparing emerging and mature markets. This study uses panel data from 45 countries in which 28 countries are developed countries and 17 developing countries from 2002 to 2012 use multivariate regression analysis and robustness checks. The results show that open markets and capital market development are the main factors in the country's ability to attract foreign investment to developed countries, but in developing countries it is precisely the government environment that attracts investment. Foreign investors in developed country markets prefer countries with more open markets. Whereas in emerging markets the choice between direct and indirect investment lies in arbitrage, investors will choose portfolio investment when the stock market is undervalued. [5].

Research conducted by Al-Khouri, 2015 on the factors that influence foreign direct and indirect investment in the MENA region. Where in this study using panel data for the period 1984-2012 with GMM calculations. The results show that there is support for the agglomeration effect, which indicates that countries that have foreign direct investment will be more attractive in the future. Economic risk affects FDI significantly but negatively, while open markets have a significant and positive effect. In

[3] Fazira, D. R., & Cahyadin, M. (2018). The Impact of interest rate, corruption perception index and economic growth on foreign direct investment. *Jurnal keuangan dan perbankan*, 707-713.

[4] Gani, W. (2014). Pengaruh Political Risk, GDP, GNP, Kurs, Wage Cost terhadap Foreign Direct Investment di Indonesia. *FINESTA*, 109-117.

[5] l-Khouri, R. (2015). Determinants of foreign direct and indirect investment in the MENA region. *Multinational Business Review*, *23*(2), 148–166

terms of political influence, namely law and order ethnic tension and internal conflict has a significant effect on FDI. The rate of return on the stock market capitalization has a positive effect on FPI flow. The existence of a negative influence on government structures has an impact on FPI while religious tension has a positive effect on what is FPI[6].

In this paper we aim to study the dynamic relationship between the inflow and outflow of FDI in OIC member countries on the Asian continent. This is interesting because more research is being done in countries such as ASEAN, Africa and MENA.

2. Research Methods

In carrying out this study, research was carried out using quantitative methods. Existing data in panel data regression using Eviews9 software. The type of data used is secondary data on direct investment of foreign capital, economic growth, inflation, stability of corruption and political stability of the country. The research was conducted during the 2012-2018 period with annual data so that the total total of observations was 84. For the inflation variable and the GDP per capita, the researchers obtained data from the ISDB website. As for the percentage of FDI from GDP, corruption stability and political stability are obtained from the world bank website.

The identification of variables in this study is explained as follows:

Influence of inflation on FDI flows

Inflation in an economy indicates the weakening of people's purchasing power, followed by a decline in the real value of a country's currency. This stretch of inflation will increase FDI flows. Because if inflation in a country is stagnant, it will give investors a question mark whether the funds they are going to invest will give good results.

H1: Inflation affects FDI flows in OIC countries

The effect of market size on FDI flows

The growing economy of a country shows an increase in the productivity of goods and services as well as an increase in investor interest in investing in FDI. An increase in the gross domestic product shows an increase in market size so that countries that experience an increase in GDP can become a base region in making sales.

H2: Market size affects the growth of FDI flows

Effects of corruption on FDI flows

Transparency in a country is indicated to affect the interest of investors in making real investments. Therefore, a lower level of corruption is expected to increase the inflow of FDI.

[6] Wang, L., & Li, S. (2018). Determinants of foreign direct and indirect investments from the institutional perspective: A comparative analysis between emerging and mature markets. *International Journal of Emerging Markets*, *13*(5), 1330–1347. https://doi.org/10.1108/IJoEM-01-2018-0038

H3: Corruption affects FDI flows

The effect of political stability on FDI flows

Political stability is related to the potential inflow of FDI in various countries. Maintained political stability will prevent potential uncertainty. This potential uncertainty could spur a decline in a country's FDI.

H4: Political stability affects FDI flows

To determine which model will be used in processing panel data in this study, it is necessary to test using the Hausman test and the chow test. This test aims to determine which model is suitable between the Common Effect Model, Fixed Effect Models or Random Effect Models. A chow test is conducted to select between the CEM and FEM models. The Hausman test is performed to determine whether to use FEM or REM.

Panel data regression models in this study are:

$Y\ i,t\text{-}1 = \alpha + \beta 1X1\ i,t\text{-}1 + \beta 2X2\ i,t\text{-}1 + \beta 3X3\ i,t\text{-}1 + \beta 4X4\ i,t\text{-}1 + \varepsilon\ i,t\text{-}1$ …. (1)

Eksplanation:

Y : *Foregin direct investment* (FDI)

α : Constant

β : Regression coefficient

X1: Stability of Corruption (Korp)

X2: Inflation (INF)

X3: Economic growth (Gdp)

X4: Political Stability (Politics)

3. Results and Discussion

The first step of panel data analysis is to perform multiple chow, hausman test and lagrange test. Where the three tests will show which research data uses the Commont effect model (CEM), Fixed effect model (FEM) and Random effect model (REM). The panel data estimation that has been done shows that this data uses a random effect model. Where from the results of the Hausman test, the resulting probability exceeds the significance of 0.05, namely 0.0561, it can be seen from the table below.

Table 1.1
Hausman Test

Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	9.207475	4	0.0561

Sourcer: the data is processed with eviews9

The choice of random effect model is also strengthened by the LM test results which show that the Breusch-Pagan probability is smaller than 0.05. The results of the research probability show that FDI is positively and significantly influenced by inflation, corruption and political stability. Meanwhile, the economic growth variable has a positive but insignificant relationship.

The positive results from inflation to FDI are in accordance with the research conducted (Anggraeni & Sulasmiyati, 2019) (Dewi & Cahyono, 2016). In general, inflation occurs in developing countries. The increase in consumption that occurs causes the circulation of goods in a country to be faster and of course it is also followed by an increase in production output due to the large demand for goods or services in that country. this increase in demand and the rapid circulation of goods and services followed by an increase in the amount of production ultimately increase profits for investors.

Meanwhile, the indicators of political stability which have a significant positive effect are in accordance with existing theories. Where the more stable political conditions in a country will also show an increase in the inflow of FDI. This is in line with the research conducted (Abdelaziz & Helmi, 2017) (Gani, 2014). Shocks to political stability, one of which can be caused by the presidential election, will have implications for the investment climate where foreign investors will make capital outflows, which includes developing countries in Asia as OIC members. The continuing political conflict can increase the possibility of a worsening investment climate in various countries. Therefore, in order to open up a more conducive investment climate and the entry of new fresh funds from a country, conflicts and political contests should be ended.

Corruption stability shows a significant negative relationship at the 10% level. This negative relationship is in line with research (Papaconstantinou & Tzagkanos, 2013) (Castro & Nunes, 2013) (Fazira & Cahyadin, 2018) (Abdelaziz & Helmi, 2017) which strengthens if the lower the level of corruption in Asian OIC member countries will increase the inflow. foreign direct funding.

Meanwhile, economic growth shows a positive but insignificant impact on FDI in OIC countries in Asia, which are included in developed countries. This means that investors decide to invest in developing countries OIC not based on macroeconomic conditions such as economic growth that is happening in that country. However, this positive relationship still needs attention. Henceforth, the governments of Asian OIC member countries must stabilize their domestic economies because improving economic conditions will stimulate FDI inflows. The output of this positive relationship to economic growth is not in line with research (Dewi & Cahyono, 2016) but in line with research (Fazira & Cahyadin, 2018). More can be seen in the table below.

Table 1.2
Random Effect Model Test

Dependent Variable: FDI
Method: Panel EGLS (Cross-section random effects)
Date: 10/14/19 Time: 10:02
Sample: 2012 2018
Periods included: 7
Cross-sections included: 13
Total panel (unbalanced) observations: 90
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.588272	3.810025	-0.416867	0.6778
KORP	-1.671938	0.937657	-1.783103	0.0781
INF	0.179290	0.103087	1.739207	0.0856
L_GDP	0.394772	0.403058	0.979441	0.3301
POLITIK	1.044380	0.580861	1.797986	0.0757

Effects Specification

	S.D.	Rho
Cross-section random	1.482446	0.2881
Idiosyncratic random	2.330173	0.7119

Weighted Statistics

R-squared	0.112475	Mean dependent var	1.638550
Adjusted R-squared	0.070709	S.D. dependent var	2.490069
S.E. of regression	2.401009	Sum squared resid	490.0116
F-statistic	2.692995	Durbin-Watson stat	1.649575
Prob(F-statistic)	0.036275		

Source: the data is processed by the author with Eviews 9

The adjusted value of R2 is 0.0707, i.e. the variance of the dependent variable (FDI) is explained by the independent variable at 7%. Meanwhile, from the F test of this panel data, it can be seen that the F-statistical probability value is 0.036, where the value is less than the 5% significance. This means that together, inflation, political stability, economic growth and corruption affect the outflow and inflow of FDI in Asian OIC member countries during the 2012-2018 period.

4. Conclusion

This research discusses the dynamics of foreign direct investment in OIC countries in Asia during the 2012-2018 period. The results of the 13 sample countries show that inflation and political stability have the most significant effect on FDI outflows. Meanwhile, the variables of economic growth and stability of corruption are less significant in showing the results.

Maintaining political stability is a strong determinant of attracting foreign investors to consider their investment. So the government must push to maintain political stability. Because with better political stability, it is hoped that it will produce output in the form of policies related to facilitating the development of the real sector. With good prospects for the real sector, investors are increasingly eager to invest in this country. Likewise with the inflation factor, the government must be able to maintain inflation at a certain level so that the stability of FDI can be maintained.

This finding is also expected to be taken into consideration by investors in analyzing or choosing investment decisions in a country classified as a home country and host country.

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