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by Windra Swastika

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Factors Affecting Foreign Direct Investment in Five ASEAN Countries and Its Implication for Indonesia in Entering ASEAN Economic Community

By

Stefanus Yufra M. Taneo
Ma Chung University
Faculty of Business and Economics
Stefanus.yufra@machung.ac.id

48

ABSTRACT

Foreign Direct Investment (FDI) plays an important role in a country economy and therefore it attracts a great attention from government and policymakers. There is a lack of studies concerning FDI for ASEAN countries, most existing study focus on specific country. Therefore, this article tries to fill the gap by analyzing factors affecting FDI in five ASEAN countries (Indonesia, Malaysia, Philippines, Singapore, and Thailand) by making use of data from the Global Competitiveness Report and Doing Business during the period of 2008 to 2013. Institution, infrastructure, paying taxes, corruption, and market size were used as exogenous variables with FDI as the endogenous variable. Data were analyzed using Generalized Structured Component Analysis (GSCA). It was found that FDI in the five ASEAN countries is positive and significantly affected by infrastructure and market size. Infrastructure is also a mediating variable for paying taxes and corruption with FDI. It is interesting that corruption is positive and significantly affect infrastructure. Moreover, corruption is positive and significantly affected by institutions. The findings have some implication for Indonesia in entering the single market in 2015. First, infrastructure development plays an important role in determining FDI. Infrastructure has direct effect and at the same time it mediates the effect of taxation and corruption on FDI. Second, infrastructure development will also increase corruption and therefore efforts to eliminate corruption should be the first priority by the government. Third, shifting the market potential into effective market will improve market size effectiveness in attracting FDI.

Keywords: FDI, ASEAN, competitiveness, doing business, GSCA, single market

46

1. INTRODUCTION

Foreign Direct Investment (FDI) as a major source of capital inflow into a country, mostly are developing countries, has long been considered to be conducive to the economic growth of developing countries. FDI is widely viewed as an important catalyst for the economic transformation of the transition economies. The most widespread belief among researchers and policy makers is that FDI boosts growth through different channels (Srinivasan *et al.*, 2010). FDI increases the capital stock and employment, stimulates technological change through technological diffusion and generates technological spillover for local firms. Policymakers are interested in this mechanism in order to increase economic growth of a country.

59 FDI policy for Indonesia is an integrated part of ASEAN countries should considered the regional economic integration, ASEAN Free Trade Area (AFTA), even international economic integration such as ASEAN China Free Trade Area (ACFTA). During the past few years, ASEAN countries have experienced a considerable increase in FDI inflows. Utama and Peridy (2009) for example, noted that FDI inflows in ASEAN countries increased 156 percent during the period of 2000 and 2007 and it is much greater than that recorded at world level (30 percent).

Uttama and Peridy have noted also that Singapore, Thailand, and Malaysia were the previous main recipients of FDI then followed by Indonesia, Philippines, and Vietnam for which FDI inflows have more than tripled between 2004 and 2007.

In order to boost FDI in the region, ASEAN governments have reached an agreement concerning the ASEAN Investment Area (AIA) in 1998, as a means of facilitating free flows of direct investment, technology, and skilled labor (ASEAN Secretariat, 2008). More recently, the AIA has been deepened through the ASEAN Comprehensive Investment Agreement (ACIA) which was implemented 2007. This agreement include further steps towards liberalization, facilitation, protection and promotion of investment. Basically, the objective of this agreement is to boost FDI inflows as a means to foster economic growth through production and employment increases as well as spillover effects. More recently, ASEAN government stressed the importance of the ACIA, in order to “further enhance regional integration to realize the vision of the ASEAN Economic Community” (ASEAN Secretariat, 2009).

From an empirical point of view, there is still a lack of literature concerning FDI for ASEAN countries, most existing study focus on specific ASEAN countries, such as Thailand (Milner and Reed, 2004) or Malaysia (Ang, 2008; Wong, 2005; Min, 2003) and some other studies the determinants of FDI between ASEAN and specific countries, like China (Shu and Zeng, 2006) (Uttama and Peridy, 2009). Moreover, the theoretical framework of FDI determinants is also incomplete, since it essentially focuses in the bilateral determinants of FDI. Therefore, there is a lack of literature and studies focusing on FDI determinants for all or main ASEAN countries simultaneously.

The article is aimed at filling the gap by using the data from the Global Competitiveness Report (GCR) and Doing Business (DB). There are 12 pillars in the GCR and 11 topics in the Doing Business, however this article focuses only to five factors that are the most problematic factor in doing business in ASEAN: institution, infrastructure, paying taxes, corruption, and market size.

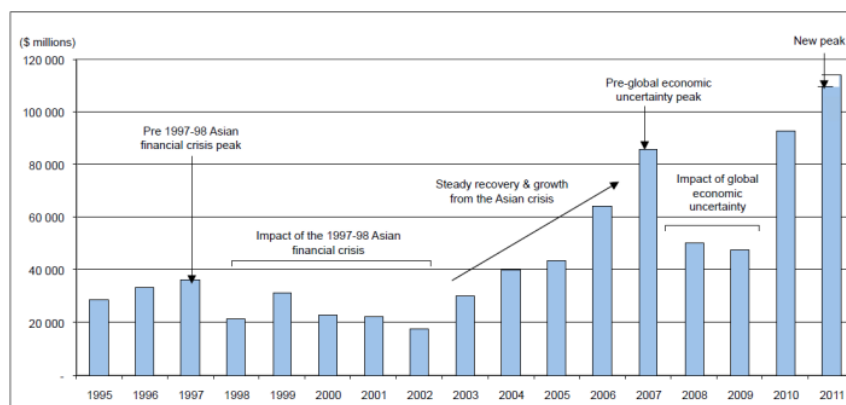
The purpose in the article is to investigate the effect of institution, infrastructure, taxes, corruption, and market size on foreign direct investment (FDI) in five ASEAN countries and its impacts for Indonesia in entering the ASEAN Economic Community (AEC). In order to achieve the purpose the article is organized as follows. Literature review on FDI and economic union is presented after the introduction. The next part is the methodology consists of conceptual model that depicts the relationship among related variables, source and type of data, and statistical tools or technic used in analyzing the data. Moreover, the results and discussion will be presented. Factors affecting FDI in the five ASEAN countries will be presented first then followed by its implication for Indonesia in facing the single market economy in the region. The last part is the conclusion drawn for the article.

2. LITERATURE REVIEW

2.1 Foreign Direct Investment (FDI) in ASEAN

Foreign Direct Investment (FDI) is an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)(Srinivasan *et al.*, 2010). According to Dunn and Mutti (2000), FDI has grown more rapidly than national income in most industrialized countries since 1980.

Data from the ASEAN Investment Report 2012 showed that 2011 ushered in an all-time high level of FDI inflows into the region at \$114.1 billion – a 24% increase over the level in 2010 (Figure 1). FDI inflows in 2010 rose by 97% as compared with a year early. The 2011 level exceeded the peak of 1997 by 2.2 times and 36% from the peak of the pre-global financial crisis in 2007. These two consecutive years of increase (2010-2011) and the high absolute level of inflows suggest a growing confidence of investors in ASEAN as an investment destination of choice.



Sources: ASEAN Secretariat, ASEAN FDI database and UNCTAD FDI database.

Figure 1. ASEAN: FDI Flows, 1995-2011

Most of the FDI inflows (about 77%) in 2011 came from outside ASEAN. Flows from the dialogue partners of ASEAN (such as European Union, the US, Japan, Republic of Korea, Australia, Canada, China) are significant, accounting for more than 40% of total inflows. The source of FDI flows to ASEAN is now less concentrated than a decade ago. A majority of member states attracted higher FDI inflows (Table 1). In 2011 most countries saw inflows increase by more than 30% compared with 2010. Two countries received inflows that hovered around the level of 2010 despite the difficult global economic situation, underscoring their resilience as location for FDI. Singapore, Indonesia, and Malaysia are the most recipient of FDI inflow.

Table 1. ASEAN: FDI Inflows, 2006-2011 (Millions of dollars)

	2006	2007	2008	2009	2010	2011 ^p
ASEAN	63,689.2	84,152.4	49,289.7	46,896.7	92,278.6	114,110.6
Brunei Darussalam	434.0	260.2	330.1	371.4	625.4	1,208.3
Cambodia	483.2	867.3	815.2	539.0	782.6	891.7
Indonesia	4,913.8	6,928.3	9,318.1	4,876.8	13,770.9	19,241.6
Lao PDR	187.4	323.5	227.8	318.6	332.6	300.7
Malaysia	6,072.4	8,538.4	7,248.4	1,405.1	9,155.9	12,000.9
Myanmar ¹	427.8	714.8	975.6	963.3	450.2	0.0
Philippines	2,921.0	2,916.0	1,544.0	1,963.0	1,298.0	1,262.0
Singapore	36,389.9	45,534.6	10,712.2	24,006.1	48,751.6	63,997.2
Thailand	9,459.6	11,330.2	8,539.5	4,853.5	9,111.6	7,778.1
Viet Nam	2,400.0	6,739.0	9,579.0	7,600.0	8,000.0	7,430.0

^p: Preliminary

¹ Myanmar's fiscal year starts on 1st April and ends on 31st March of the following calendar year. Data for 2011 is not yet available.

Sources: ASEAN Secretariat, ASEAN FDI database (extracted on 30 September 2012) and UNCTAD, FDI database.

FDI inflow to ASEAN countries going to various industries that reflected a country strength and resource endowments. These industries include agriculture, fishery and forestry; mining and quarrying, manufacturing, construction, trade and commerce, finance, real estate, and services. The ASEAN Comprehensive Investment Agreement (ACIA) offers the following facilitations: investment liberalization, investment facilitation, investment protection, and investment promotion (Chia, 2013).

2.2 Economic Integration

Economic integration in ASEAN began with the 1992 ASEAN Free Trade Area (AFTA) that covers trade in goods, complemented by the 1995 ASEAN Framework Agreement on Services (AFAS) and the 1998 ASEAN Investment Area (AIA) agreement. In 2003 it was agreed to deepen economic integration with the formation of the ASEAN Economic Community to create a unified market and production base via a free flow of goods, services, foreign direct investment, skilled labor, and a freer flow of capital.

Chia (2013) highlight factors pushing or impeding ASEAN Economic integration as follows: geopolitical factors favoring regional cooperation, initial economic diversity and impediment to regional integration, initial similar production and export structures an impediment to regional integration, pressure to be competitive with transition to outward-looking development strategies, and external pressures toward economic integration.

The economic literature lists several benefits of economic integration including an enlarged market with economies of scale and scope, improved resource allocation with free movement of factors of production, improved resource pools with inflows of capital, investment and labor, and increased competition leading to improved efficiency and innovation (Jovanovic, 2011).

2.3 ASEAN Economic Community

In October 2003, ASEAN decided to established the ASEAN Economic Community (AEC) by 2020 but advance it to 2015 in January 2007 with a longer time line of 2018 - 2020 for Cambodia, Lao PDR, Myanmar, and Viet Nam). In November 2007, the AEC Blueprint outlining various measures and strategic schedules for implementation was adopted. In April 2009 the Declaration on the Roadmap for the ASEAN Community (2009 - 2015) agreed to an accelerated timetable for the realization of the AEC. In April 2012 ASEAN agreed to redouble efforts and set priority activities and concrete key actions to realize the AEC by 2015 (Chia, 2013).

ASEAN Economic Community has the following characteristics: (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy. These characteristics are inter-related and mutually reinforcing (ASEAN Secretariat, 2008). An ASEAN single market and production base shall comprise five core elements: (i) free flow of goods, (ii) free flow of services, (iii) free flow of investment, (iv) free flow of capital; and (v) free flow of skilled labor. In addition, the single market and production base also include two important components, namely, the priority integration sectors, and food, agriculture and forestry.

The creation of a single market and production base should allow ASEAN to benefit from economies of scale and efficiency in production network processes. A CGE model of the AEC by Plummer and Chia (2009), incorporate assumptions on the complete elimination of tariffs and non-tariff barriers (NTBs), the liberalization of five service sectors, AEC-induced changes in FDI, and a 5% reduction in trade costs as shown in Table 2 found several important points. First, ASEAN economic welfare under the AEC should rise by 5.3% relative to the baseline. All ASEAN countries benefit, although some benefit more than others, either absolutely or relative to GDP size. Second, to estimate the direct effects of behind-the-border measures and best practices spread by means of AEC, the projections suggest that competition policy alone could rise per capita GDP by 26-38% in ASEAN6. By creating opportunities for production networks and spreading best practices that boost productivity, AEC should help CLMV converge with ASEAN6. Third, the net benefits of the AEC would be larger than the estimated 5.3% increase in ASEAN economic welfare, due to gains that have not been quantified by the CGE model.

Table 2. Welfare Gains of the AEC in 2015

	AFTA	AEC	AFTA	AEC
	\$ billion, 2004 price		Percent of baseline GDP	
Brunei Darussalam	0.2	0.5	2.6	7.0
Indonesia	1.0	27.6	0.2	6.2
Malaysia	2.7	5.7	1.4	3.0
Philippines	0.9	4.5	0.6	3.2
Singapore	2.6	15.1	1.6	9.7
Thailand	1.6	12.2	0.6	4.9
Cambodia	0.3	0.6	2.7	6.3
Lao PDR	0.0	0.2	0.6	3.6
Myanmar	0.0	0.6	0.3	4.4
Viet Nam	0.9	2.4	1.1	2.8
ASEAN total	10.1	69.4	0.8	5.3

AEC = ASEAN Economic Community; AFTA = ASEAN Free Trade Area; ASEAN = Association of Southeast Asian Nations; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic. Source: Plummer and Chia (2009).

3. METHOD

3.1 Conceptual Model

Previous studies on FDI are focused on macroeconomic models such as Lee and Tan (2006) and Srinivasan *et al.* (2010). Masron and Yusop (2012) used a model of specification based on the motives for FDI: namely market-seeking, efficiency-seeking, resource-seeking, and economic policy. The proposed model of this article is based on the survey on the most problematic factors in doing business published as an integrated part of Global Competitiveness Report and Ease Doing Business Report. For Indonesia and other ASEAN countries except Singapore, three most problematic factors in doing business are corruption, infrastructure, and inefficient bureaucracy. The similar survey reported in Doing Business is that paying taxes as a key factor determine FDI. One of the strength point of ASEAN Economic Community is the market size which is considered to be an advantage for single market production base.

Based on the above consideration this article proposed the following conceptual model to be tested using empirical data.

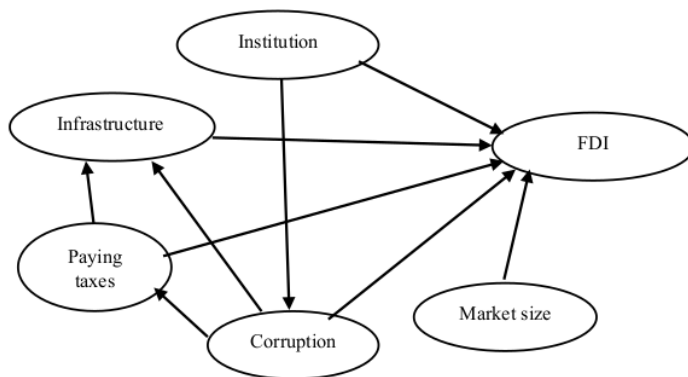


Figure 2. Conceptual Model of Factors Affecting FDI

The latent variables of institution, infrastructure, and market sized and their manifest variables were adopted from the Global Competitiveness Report. Paying taxes was adopted from Doing Business Report and the Corruption was adopted from Corruption Perception Index. Table 3 presents the latent and manifest variables and their measurement.

Table 3. Variables and Measurement

No.	Latent Variables and Manifest variable (indicators)	Measurement
1	Institution	
1.1	Property rights	
1.2	Intellectual property protection	
1.3	Diversion of public funds	
1.4	Public trust in politicians	
1.5	Judicial independence	55
1.6	Favoritism in decisions of government officials	Scores on a 1-7 scale, with 7
1.7	Wastefulness of government spending	being the most desirable outcome
1.8	Burden of government regulation	
1.9	Transparency of government policymaking	
1.10	Business cost of terrorism	
1.11	Business cost of crime and violence	
1.12	Organized crime	
1.13	Reliability of police service	
1.14	Ethical behavior of firm	
1.15	Strength of auditing and reporting standards	
1.16	Efficacy of corporate boards	
1.17	Protection of minority shareholders' interests	
63		
2	Infrastructure	
2.1	Quality of overall infrastructure	Score 1 – 7, with 7 being the
2.2	Quality of roads	most desirable outcome
2.3	Quality of railroad infrastructure	
2.4	Quality of port infrastructure	
2.5	Quality of air transportation	Million
2.6	Quality of electricity supply	Score 1 – 7, with 7 being the
2.7	Fixed telephone lines/100 population	most desirable outcome
		Per 100 people
3	Paying taxes	
3.1	Payments	Total number of taxes paid per
3.2	Time	year 7
7		Time require to comply with 3
3.3	Total tax rate	major taxes in hour per year
		% of profit before all taxes
4	Corruption	
4.1	Corruption perception index	Score 0 – 10, with 10 being
		the most clean
5.	Market size	
5.1	Domestic market size index	Score 1 – 7, with 7 being the
5.2	Foreign market size index	most desirable outcome

5.3	GDP	PPP US \$ billions
6	Foreign Direct Investment (FDI)	
6.1	Capital inflow to a country	US \$ million

3.2 Data

Data were taken from various sources. The data of institution, infrastructure, and market size were taken from The Global Competitiveness Report published by The World Economic Forum. Data of taxes was taken from Doing Business: Economy Profile which is a co-publication of The World Bank and the International Finance Corporation. Data of corruption was taken from Transparency International, and FDI taken from Economy Country Profile of each country.

The data were collected from 2008 to 2013 for the five ASEAN countries: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Thus, data used in the analysis is a pooled data of 30 observations. Selection these countries was based on the division of ASEAN countries into ASEAN-6 and CLMV (Cambodia, Lao PDR, Myanmar, and Viet Nam). ASEAN-6 include Brunei Darrusalam but it is excluded from the analysis due to incomplete data for some variables and indicators.

3.3 Analysis

Generalized Structured Component Analysis (GSCA) was applied the proposed model based on the following considerations. First, limited data due to the Global Competitiveness Report and Doing Business started to publish in yearly bases in 2008. According to Hwang (2009), GSCA is a new method of structural equation modeling based on component analysis and it is very important tool that can be used in calculating scores not scale and more importantly the method can be applied in a very small sample. Second, GSCA can be applied to a structural model with reflective and formative indicators as well as non-recursive model (Solimun, 2013).

GSCA fit the model due to limited number of observation and combine reflective and formative indicators as well as non-recursive model. Indicators for Latent variables of institution, infrastructure, paying taxes, and corruption are reflective meanwhile market size and FDI are formative. The data analysis was run by making use of online software from the website: www.sem-gesca.org and is in real time.

4. RESULT AND DISCUSSION

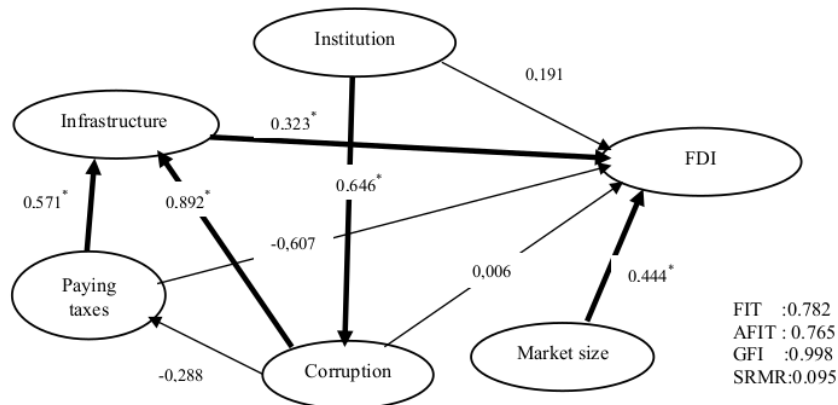
4.1 Statistical Result

The statistical result from GSCA software is fit the data which is indicated by the following goodness of fit model. FIT and AFIT are relatively high, 0.782 and 0.765. It means that approximately 77% variance of FDI can be explained the exogenous variables. GFI is higher than the cut off (0.998 > 0.900) and SRMR is marginal fit because it is lies in between 0.08 and 0.10.

The statistical result (Figure 3) showed that infrastructure and market size are significantly affect FDI in Five ASEAN countries. Infrastructure is positively affected by taxes and corruption. Corruption is positively affected by infrastructure. Corruption, infrastructure, and taxes are intervening or mediating variable and therefore need to be tested either those variables are partial or complete mediation.

Testing the mediating variables are done by excluding that variables from the model. When corruption is excluded from the model, institutions is insignificant and therefore corruption is not a mediating variable between institution and FDI. If infrastructure is excluded, corruption is insignificant on FDI. Thus, it is clear that infrastructure is a complete mediating variable between corruption and FDI. It is interesting that paying taxes become significant when infrastructure is excluded from the model. Due to paying taxes significantly affect FDI as well as infrastructure and infrastructure is also significantly affect FDI, it can be concluded that infrastructure is a partial mediation between paying taxes and FDI. Finally, without paying taxes in the model, corruption

still insignificant so that paying taxes is neither partial nor complete mediation between corruption and FDI.



* significant at .05 level

Figure 3. Empirical Results of Factors Affecting FDI

-0.598 taxes → FDI. $0.571 \times 0.323 = 0.184$

-0.030 corruption → FDI: not significant

4.2 Discussion

Statistical analysis found that infrastructure and market size are positively affect FDI in the five ASEAN countries. Extensive and efficient infrastructure is critical for ensuring the economy, as it is an important factor in determining the location of economic activity and the kinds of activities or sectors that can develop within a country. Well-developed infrastructure reduces the effect of distance between regions, integrating the national market and connecting it at low cost to markets in other countries and regions. In addition, the quality and extensiveness of infrastructure networks significantly impact economic growth and reduce income inequalities and poverty in a variety of ways. A well-developed transport and communications infrastructure network is a prerequisite for the access of less-developed communities to core economic activities and services.

Effective modes of transport, including quality roads, railroads, ports, and air transport enable entrepreneurs to get their goods and services to market in a secure and timely manner and facilitate the movement of workers to the most suitable jobs. Khadaroo and Seetanah (2008) claim that gains rendered by infrastructure growth are associated with greater accessibility and reduction in transportation costs. Furthermore, public goods reduce the cost of doing business for foreign enterprises which leads towards maximization of profit. Empirical studies also propose that public goods have vital impact on cost structure and productivity of private firms (Quere *et al.*, 2007). Nadiri and Mamuneas (1994) reported a cost elasticity forecasts with reference to infrastructure capital range from -0.1 to -0.21 depending on the business sector. Availability of public goods lower the cost of private firms even if there is no direct role of infrastructure in the production performance and cost structure of private firms (Haughwout, 2001).

Poor infrastructure, on the contrary, causes increase in transaction cost and limits access to both local and global markets which ultimately discourage FDI in developing countries. A greater efficiency can be achieved in extending infrastructure facilities by considering commercial principle and shifting liability for provisioning of infrastructure facilities through management contracts or leases. As a matter of fact, privatization has come up with a useful source of attracting inward FDI (Mlambo, 2006).

Market size affect productivity since large market allow firms to exploit economies of scale. Traditionally, the markets available to firms have been constrained by national borders. In the era of globalization, international market have become a substitute for domestic markets, especially for small countries. Vast empirical evidence shows that trade openness is positively associated with growth. Even if some recent research casts doubts on the robustness of this relationship, there is a general sense that trade has a positive effect on growth, especially for countries with small domestic markets (Alesina *et al.*, 2005; Feyrer, 2009). Thus exports can be thought of as a substitute for domestic demand in determining the size of the market for the firms of a country. By including both domestic and foreign markets in our measure of market size, we give credit to export-driven economies and geographic areas, such as European Union or ASEAN in 2015, that are divided into many countries but have a single common market.

Bayraktar (2013) used the World Bank Doing Business database from 2004 – 2010 to analyze correlation between ease doing business and FDI in developing and developed countries. The analysis showed that countries which have better records of “doing business” tend to attract more FDI. The improvement in “ease of doing business” indicators in developing countries can have a partial explanatory power in determining higher FDI flows to these countries. The study specifically found that there is a negative correlation between paying taxes and FDI inflow to a country.

Tax is the main funding source for infrastructure development. As noted by IMF (cited in TJN, 2012): “Developing countries must be able to raise the revenues required to finance the services demanded by their citizens and the infrastructure (physical and social) that will enable them to move out poverty. Taxation will play the key role in this revenue mobilization ...”. The main reason for taxation is to finance government expenditure and to redistribute wealth which translates financing development of the country (Jhingan, 2004; Bhartia, 2009).

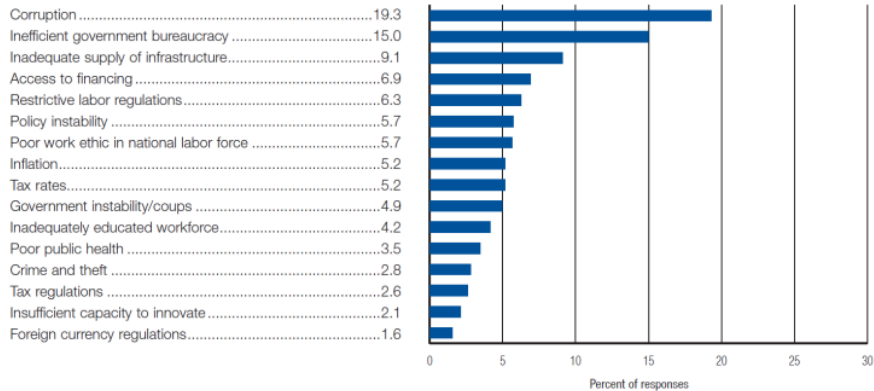
It is interesting that infrastructure is positive and significantly affected by corruption. It means that corruption and infrastructure development have same direction. Keny (2006) reported that a low-end estimate suggest that the financial costs of corruption in infrastructure investment and maintenance alone in developing countries might equal \$18bl a year. There is considerable evidence of widespread petty corruption in the area of infrastructure connections as well as larger-scale corruption to gain construction contracts and licenses and even to change regulatory and policy practices. Corruption hinders economic growth through its adverse effects on investment in physical capital, human capital, and political instability. Concurrently, corruption is found to foster growth by reducing government consumption and, less robustly, increasing trade openness. Moreover, the results appear supportive of the notion that the negative effect of corruption on growth is diminished in economies with low governance levels or a high degree of regulation (Hodge *et al.*, 2009).

The finding of the statistical analysis is that institution has a positive and significantly affect corruption. It can be interpreted that institutions in the region support corruption. Ebben and de Vaal (2009) find that particularly in situations where institutions are not well developed corruption may be conducive to grow. In these instances the positive effect of corruption on the working of the institution system outweighs the negative direct effects of corruption on growth. It is also find that the interaction among institutions themselves matters. This underscores the importance of taking into account the complete institutional setting when studying corruption, both in theory as well as in empirics.

4.3 The Implication for Indonesia

The similar statistical analysis on FDI in ASEAN countries cannot be applied to Indonesia due to inadequate quantitative data. However, it is quite clear relationship between infrastructure and market size with FDI, the role of infrastructure as a mediating variable, and the relationship between institution and corruption. Infrastructure and market size are positive and significantly affect FDI in the five ASEAN countries. The Global Competitiveness Report 2013 showed that infrastructure is the third problematic factor in doing business in Indonesia, after corruption and inefficient government bureaucracy (Figure 4). The problematic factors are based on a survey of business executives. From a list of 16 factors, respondents were asked to select the five most problematic and rank them from 1 (most problematic) to 5. Thus, if Indonesia have a willingness to increase FDI then improving quality of infrastructure is a must. All indicators for infrastructure presented in Table 1 need to be improved due to their rank are in between 62 and 89 among 148 countries, except quality of railroad rank 44.

Market size is positive and significantly affect FDI in the five ASEAN countries. Compare with other ASEAN countries, Indonesia have an advantage in terms of market size since Indonesia is the largest population in the region. The Global Competitiveness Report 2013-2014 (Figure 5) depicted that market size is the most advantage factor among the 12 pillars of global competitiveness index compare with the average scores across all the economies in the same stage of development (black line). Indonesia has a great opportunity to increase economic activity, both production and consumption, which is an advantage of investment. The challenge is to shift the potential market to the effective one.



Note: From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

Figure 4. The Most Problematic Factors for Doing Business in Indonesia, 2013.
Source: The Global Competitiveness Report 2013 – 2014.



Figure 5. Pillars of Global Competitiveness Index for Indonesia, 2013.
 Source: The Global Competitiveness Report 2013-2014

Infrastructure is a mediating variable between corruption and paying taxes with FDI in the five ASEAN countries. Corruption and paying taxes have positive affect on FDI. Taxes from citizen is a key source of finance for infrastructure development, so that increasing tax revenue will improve and foster infrastructure development. However, data from the World Bank Doing Business database (Figure 6) showed that Indonesia have low performance in paying taxes as it rank 137 among 189 countries. Even though Indonesia is relatively good in protecting investor (rank 52) compare with other doing business factors, it is still need efforts to improve paying taxes performance. In 2013, on average, in Indonesia firms make 52 tax payments a year, spend 259 hours a year filing, preparing and paying taxes and pay total taxes amounting to 32.2% of profit (Doing Business Indonesia, 2013). Economies around the world have made paying taxes faster and easier for businesses – such as by consolidating filing, reducing the frequency of payments or offering electronic filing and payment. Many countries have lowered tax rate. Meanwhile Indonesia only made tax reform in 2011 by reduced corporate income tax rate and no reform afterwards.

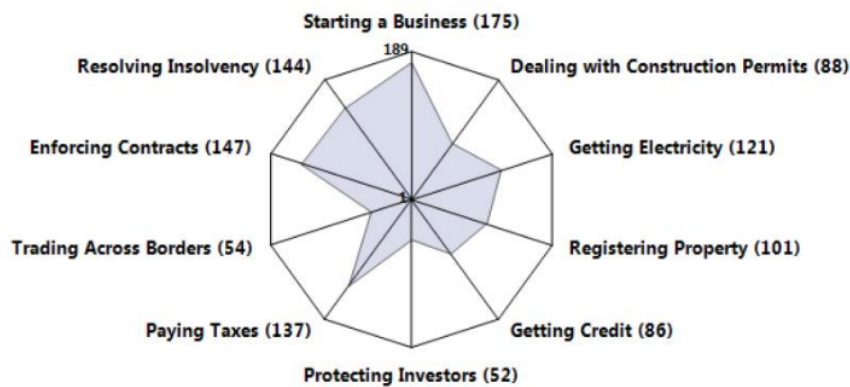


Figure 6. Doing Business Indonesia 2013
Source: Doing Business 2014, Economy Profile: Indonesia

Positive affect of corruption on infrastructure in the five ASEAN countries raising a question whether it is similar finding for Indonesia. It seems that there is a positive relationship between corruption and infrastructure development. Keny (2006) gave an example of his finding that as much as 24 percent of fund destined for road construction in a project in Indonesia 'went missing' and in the region of seven percent of government contracts values are paid in bribes according to survey respondents in Eastern Europe and Central Asia.

5. CONCLUSION

Foreign Direct Investment (FDI) have a lot benefits for the host country, such as create job opportunities, transfer of technological knowledge, higher productivity, and higher value-added activities. Therefore, FDI attract a great attention from government and policymakers especially from developing countries. Many studies about factors affecting FDI have been done for a country, but it is a lack of study about FDI for a free trade are such as ASEAN. This article tries to fill the gap by analyzing factors affecting FDI in five ASEAN countries.

The article find that FDI in the five ASEAN countries positive and significantly affected by infrastructure and market size. Infrastructure is also a mediating variable for paying taxes and corruption with FDI. It is interesting that corruption is positive and significantly affect infrastructure. Moreover, corruption is positive and significantly affected by institutions. Low quality of institution give an opportunity for corruption included bribery in infrastructure development.

The findings have some implication for Indonesia in entering the single economy in 2015. First, infrastructure development plays an important role in determining FDI. It has direct effect to FDI and at the same time it mediates the effect of taxation and corruption on FDI. Second, infrastructure development will also increase corruption and therefore efforts to eliminate corruption should be the first priority because it is the first of the most problematic factor in doing business in Indonesia. Third, shifting the market potential into effective market will improve market size effectiveness in attracting FDI.

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Appendices

44

Model Fit	
FIT	0.782
AFIT	0.765
GFI	0.998
SRMR	0.095
NPAR	67

Measurement Model

Variable	Loading			Weight			SMC		
	Estimate	SE	CR	Estimate	SE	CR	Estimate	SE	CR
Institution	AVE = 0.891, Alpha =-0.325								
X11	-0.763	0.212	3.6*	-0.048	0.037	1.29	0.582	0.172	3.39*
X12	0.657	0.108	6.11*	0.008	0.696	0.01	0.432	0.138	3.12*
X13	0.952	0.016	59.58*	0.033	1.960	0.02	0.907	0.030	30.08*
X14	0.921	0.019	49.46*	0.123	0.970	0.13	0.848	0.034	24.86*
X15	0.989	0.006	174.57*	0.095	1.623	0.06	0.978	0.011	87.61*
X16	0.968	0.013	72.52*	0.076	1.268	0.06	0.938	0.026	36.54*
X17	0.984	0.007	141.84*	0.042	1.922	0.02	0.968	0.014	71.25*
X18	0.989	0.005	209.98*	0.039	1.161	0.03	0.978	0.009	105.22*
X19	0.986	0.008	131.12*	0.093	1.946	0.05	0.973	0.015	65.95*
X110	0.934	0.025	36.8*	0.033	1.091	0.03	0.873	0.046	18.81*

X111	0.988	0.004	226.8*	0.094	1.590	0.06	0.976	0.009	113.67*
X112	0.987	0.005	215.25*	0.064	1.169	0.05	0.974	0.009	108.04*
X113	0.989	0.006	156.89*	0.022	0.901	0.02	0.978	0.012	78.76*
X114	0.975	0.012	80.3*	0.079	1.178	0.07	0.951	0.023	40.54*
X115	0.971	0.012	80.21*	0.054	1.994	0.03	0.943	0.023	40.49*
X116	0.962	0.015	63.67*	0.099	1.809	0.06	0.926	0.029	32.25*
X117	0.963	0.016	58.91*	0.042	2.671	0.02	0.928	0.031	29.73*
Infrastructure									
AVE = 0.765, Alpha =-0.910									
X21	0.986	0.011	93.72*	0.438	0.113	3.89*	0.972	0.021	47.19*
X22	0.982	0.010	94.29*	-0.205	0.107	1.92	0.965	0.020	47.47*
X23	0.938	0.015	62.15*	0.039	0.055	0.71	0.880	0.028	31.06*
X24	0.995	0.001	723.68*	0.303	0.129	2.35*	0.991	0.003	362.03*
X25	0.957	0.025	38.66*	0.250	0.061	4.1*	0.916	0.046	19.8*
X26	0.545	0.139	3.93*	0.020	0.045	0.44	0.297	0.145	2.04*
X27	0.993	0.003	305.9*	0.156	0.114	1.36	0.987	0.006	153.35*
X28	0.342	0.104	3.3*	0.078	0.035	2.23*	0.117	0.070	1.68
Tax									
AVE = 1.000, Alpha =0.000									
X31	1.000	0.000	-	1.000	0.000	-	1.000	0.000	-
Corruption									
AVE = 1.000, Alpha =0.000									
X41	1.000	0.000	-	1.000	0.000	-	1.000	0.000	-
Market Size									
AVE = 0.000, Alpha =-0.056									
X51	0	0	0	1.022	0.011	94.87*	0	0	0
X52	0	0	0	0.155	0.058	2.66*	0	0	0
FDI									
AVE = 1.000, Alpha =0.000									
Y	1.000	0.000	-	1.000	0.000	-	1.000	-nan	0.0

CR* = significant at .05 level

Structural Model

Path Coefficients			
	Estimate	SE	CR
Institution->Corruption	0.646	0.059	10.94*
Institution->FDI	0.191	0.150	1.28
Infrastructure->FDI	0.323	0.093	3.48*
Tax->Infrastructure	0.571	0.069	8.3*
Tax->FDI	-0.607	0.127	4.78*
Corruption->Infrastructure	0.892	0.090	9.92*
Corruption->Tax	-0.288	0.175	1.64
Corruption->FDI	0.006	0.168	0.04
Market Size->FDI	0.444	0.119	3.73*

CR* = significant at .05 level

R square of Latent Variable

Institution	0
Infrastructure	0.829
Tax	0.083
Corruption	0.417
Market Size	0
FDI	0.991

Means Scores of Latent Variables	
Institution	3.655
Infrastructure	4.175
Tax	24.290
Corruption	5.727
Market Size	11.550
FDI	0.823

Correlations of Latent Variables (SE)						
	Institution	Infrastructure	Tax	Corruption	Market Size	FDI
Institution	1	0.973 (0.154)*	0.431 (0.186)*	0.646 (0.104)*	0.306 (0.138)*	0.899 (0.180)*
Infrastructure	0.973 (0.154)*	1	0.314 (0.174)	0.728 (0.037)*	0.350 (0.142)*	0.850 (0.069)*
Tax	0.431 (0.186)*	0.314 (0.174)	1	-0.288 (0.175)	-0.379 (0.155)*	-0.625 (0.103)*
Corruption	0.646 (0.104)*	0.728 (0.037)*	-0.288 (0.175)	1	0.690 (0.158)*	-0.483 (0.084)*
Market Size	0.306 (0.138)*	0.350 (0.142)*	-0.379 (0.155)*	0.690 (0.158)*	1	0.381 (0.078)*
FDI	0.899 (0.180)*	0.850 (0.069)*	-0.625 (0.103)*	-0.483 (0.084)*	0.381 (0.078)*	1

* significant at .05 level

Model: without corruption

Model Fit	
FIT	0.763
AFIT	0.745
GFI	0.926
SRMR	0.071
NPAR	61

Measurement Model

Variable	Loading			Weight			SMC		
	Estimate	SE	CR	Estimate	SE	CR	Estimate	SE	CR

Institution	AVE = 0.892, Alpha =-0.325								
X11	-0.769	0.758	1.01	-0.050	0.110	0.46	0.591	0.179	3.3*
X12	0.678	0.693	0.98	0.045	0.456	0.1	0.459	0.141	3.26*
X13	0.944	0.943	1.0	0.070	2.290	0.03	0.891	0.031	28.7*
X14	0.912	0.914	1.0	0.058	1.189	0.05	0.833	0.036	22.98*
X15	0.989	0.987	1.0	0.073	1.353	0.05	0.979	0.010	97.57*
X16	0.966	0.964	1.0	0.063	0.773	0.08	0.932	0.024	38.47*
X17	0.982	0.980	1.0	0.064	2.656	0.02	0.965	0.015	65.66*
X18	0.989	0.987	1.0	0.058	1.544	0.04	0.979	0.009	113.78*
X19	0.987	0.985	1.0	0.066	1.935	0.03	0.974	0.014	69.15*
X110	0.941	0.938	1.0	0.077	1.809	0.04	0.886	0.044	20.24*
X111	0.990	0.988	1.0	0.050	3.028	0.02	0.980	0.007	132.91*
X112	0.988	0.987	1.0	0.062	1.266	0.05	0.977	0.008	128.94*
X113	0.988	0.985	1.0	0.063	2.394	0.03	0.976	0.013	77.72*
X114	0.970	0.968	1.0	0.073	2.324	0.03	0.941	0.024	38.42*
X115	0.975	0.972	1.0	0.054	2.792	0.02	0.950	0.023	40.62*
X116	0.965	0.963	1.0	0.071	1.128	0.06	0.932	0.029	32.67*
X117	0.962	0.958	1.0	0.060	0.862	0.07	0.925	0.036	25.4*
Tax	AVE = 1.000, Alpha =0.000								
X31	1.000	0.000	-	1.000	0.000	-	1.000	0.000	-
Market Size	AVE = 0.000, Alpha =-0.056								
X51	0	0	0	1.021	0.013	80.04*	0	0	0
X52	0	0	0	0.144	0.060	2.38*	0	0	0
FDI	AVE = 1.000, Alpha =0.000								
Y	1.000	0.000	-	1.000	0.000	-	1.000	-nan	0.0
Infrastructure	AVE = 0.765, Alpha =-0.910								
X21	0.986	0.010	96.39*	0.465	0.170	2.74*	0.972	0.020	48.49*
X22	0.983	0.010	98.04*	-0.132	0.169	0.78	0.967	0.020	49.29*
X23	0.908	0.023	39.65*	0.053	0.055	0.96	0.825	0.042	19.75*
X24	0.988	0.003	301.66*	0.138	0.082	1.67	0.977	0.006	150.85*
X25	0.975	0.019	50.14*	0.271	0.065	4.18*	0.950	0.037	25.4*
X26	0.622	0.132	4.73*	0.082	0.027	3.01*	0.387	0.163	2.38*
X27	0.990	0.004	260.48*	0.164	0.061	2.7*	0.979	0.007	130.68*
X28	0.253	0.108	2.33*	0.036	0.021	1.67	0.064	0.065	0.98

CR* = significant at .05 level

Structural Model

Path Coefficients			
	Estimate	SE	CR
Institution->FDI	-0.217	0.256	0.85
Tax->FDI	-0.591	0.110	5.4*
Tax->Infrastructure	0.378	0.187	2.02*

Market Size->FDI	-0.461	0.131	3.52*
Infrastructure->FDI	-0.294	0.096	3.08*

CR* = significant at .05 level

R square of Latent Variable	
Institution	0
Tax	0
Market Size	0
FDI	0.991
Infrastructure	0.143

Means Scores of Latent Variables	
Institution	3.634
Tax	24.290
Market Size	11.474
FDI	0.823
Infrastructure	4.291

Correlations of Latent Variables (SE)					
	Institution	Tax	Market Size	FDI	Infrastructure
Institution	1	0.456 (0.478)	0.282 (0.319)	-0.903 (0.889)	0.974 (0.961)
Tax	0.456 (0.478)	1	-0.383 (0.179)*	-0.625 (0.107)*	0.378 (0.188)*
Market Size	0.282 (0.319)	-0.383 (0.179)*	1	-0.378 (0.081)*	0.281 (0.144)
FDI	-0.903 (0.889)	-0.625 (0.107)*	-0.378 (0.081)*	1	-0.858 (0.073)*
Infrastructure	0.974 (0.961)	0.378 (0.188)*	0.281 (0.144)	-0.858 (0.073)*	1

* significant at .05 level

Model: Without infrastructure

Model Fit	
FIT	0.786
AFIT	0.769
GFI	0.893
SRMR	0.917
NPAR	48

Measurement Model

Variable	Loading			Weight			SMC		
	Estimate	SE	CR	Estimate	SE	CR	Estimate	SE	CR
Institution	AVE = 0.891, Alpha = -0.325								
X11	-0.763	0.217	3.51*	-0.047	0.061	0.76	0.581	0.179	3.25*
X12	0.657	0.119	5.53*	0.007	0.733	0.01	0.431	0.148	2.92*

X13	0.952	0.018	53.58*	0.037	3.948	0.01	0.907	0.033	27.24*
X14	0.921	0.021	43.9*	0.112	4.017	0.03	0.848	0.038	22.24*
X15	0.989	0.007	143.47*	0.107	4.200	0.02	0.978	0.014	72.31*
X16	0.968	0.016	59.7*	0.069	1.621	0.04	0.938	0.031	30.24*
X17	0.984	0.008	116.59*	0.050	1.801	0.03	0.968	0.016	58.8*
X18	0.989	0.006	174.26*	0.039	1.544	0.02	0.979	0.011	87.65*
X19	0.986	0.012	84.65*	0.096	5.150	0.02	0.973	0.023	43.2*
X110	0.934	0.032	29.44*	0.049	0.939	0.05	0.873	0.057	15.34*
X111	0.988	0.006	176.19*	0.079	0.797	0.1	0.976	0.011	88.57*
X112	0.987	0.006	153.36*	0.054	4.576	0.01	0.974	0.013	77.25*
X113	0.989	0.008	119.93*	0.014	2.665	0.0	0.978	0.016	60.54*
X114	0.975	0.016	60.95*	0.102	1.511	0.07	0.951	0.031	31.15*
X115	0.971	0.016	62.66*	0.039	6.593	0.01	0.943	0.030	31.96*
X116	0.962	0.017	55.82*	0.107	1.540	0.07	0.926	0.033	28.39*
X117	0.963	0.018	53.57*	0.035	1.402	0.02	0.928	0.034	27.19*
Tax									
AVE = 1.000, Alpha =0.000									
X31	1.000	-nan	0.0	1.000	0.000	-	1.000	0.000	-
Corruption									
AVE = 1.000, Alpha =0.000									
X41	1.000	0.000	-	1.000	0.000	-	1.000	0.000	-
Market Size									
AVE = 0.000, Alpha =-0.056									
X51	0	0	0	1.014	0.022	45.53*	0	0	0
X52	0	0	0	0.078	0.087	0.89	0	0	0
FDI									
AVE = 1.000, Alpha =0.000									
Y	1.000	0.000	-	1.000	0.000	-	1.000	0.000	-

CR* = significant at .05 level

Structural Model

Path Coefficients			
	Estimate	SE	CR
Institution->Corruption	0.646	0.051	12.65*
Institution->FDI	-0.494	0.147	3.37*
Tax->FDI	-0.598	0.133	4.49*
Corruption->Tax	-0.288	0.184	1.56
Corruption->FDI	-0.030	0.234	0.13
Market Size->FDI	-0.437	0.158	2.76*

CR* = significant at .05 level

R square of Latent Variable	
Institution	0
Tax	0.083
Corruption	0.417
Market Size	0
FDI	0.989

Means Scores of Latent Variables	
Institution	3.649
Tax	24.290
Corruption	5.727
Market Size	11.042
FDI	0.823

Correlations of Latent Variables (SE)					
	Institution	Tax	Corruption	Market Size	FDI
Institution	1	0.431 (0.162)*	0.646 (0.059)*	0.294 (0.116)*	-0.899 (0.091)*
Tax	0.431 (0.162)*	1	-0.288 (0.184)	-0.407 (0.166)*	-0.625 (0.111)*
Corruption	0.646 (0.059)*	-0.288 (0.184)	1	0.702 (0.146)*	-0.483 (0.088)*
Market Size	0.294 (0.116)*	-0.407 (0.166)*	0.702 (0.146)*	1	-0.360 (0.077)*
FDI	-0.899 (0.091)*	-0.625 (0.111)*	-0.483 (0.088)*	-0.360 (0.077)*	1

* significant at .05 level

Model: without tax

Model Fit	
FIT	0.774
AFIT	0.757
GFI	0.893
SRMR	0.815
NPAR	61

Measurement Model

Variable	Loading			Weight			SMC		
	Estimate	SE	CR	Estimate	SE	CR	Estimate	SE	CR
Institution	AVE = 0.892, Alpha = -0.325								
X11	-0.772	0.107	7.19*	-0.039	0.051	0.76	0.595	0.156	3.82*
X12	0.672	0.100	6.7*	0.017	0.169	0.1	0.452	0.136	3.33*
X13	0.939	0.017	55.5*	-0.022	2.103	0.01	0.881	0.032	27.72*
X14	0.904	0.021	43.63*	0.030	1.821	0.02	0.818	0.038	21.71*
X15	0.990	0.005	201.98*	0.115	0.763	0.15	0.980	0.010	101.55*
X16	0.962	0.013	75.14*	0.023	0.438	0.05	0.926	0.025	37.62*
X17	0.978	0.009	111.62*	0.118	0.589	0.2	0.956	0.017	55.9*
X18	0.988	0.005	180.44*	0.067	0.993	0.07	0.975	0.011	90.44*
X19	0.988	0.008	122.88*	0.165	1.048	0.16	0.976	0.016	61.85*

X110	0.947	0.024	38.85*	0.089	1.760	0.05	0.897	0.045	19.88*
X111	0.992	0.005	197.68*	0.072	1.461	0.05	0.983	0.010	99.64*
X112	0.991	0.005	207.33*	0.007	0.696	0.01	0.981	0.009	104.44*
X113	0.985	0.008	125.9*	-0.058	2.157	0.03	0.970	0.015	63.21*
X114	0.967	0.013	73.57*	0.203	0.903	0.22	0.935	0.025	36.99*
X115	0.979	0.010	99.3*	0.015	1.106	0.01	0.959	0.019	50.09*
X116	0.970	0.014	68.54*	0.126	0.777	0.16	0.940	0.027	34.64*
X117	0.965	0.016	61.51*	0.034	0.892	0.04	0.931	0.030	31.05*

Market Size	AVE = 0.000, Alpha =-0.056								
X51	0	0	0	0.979	0.937	1.04	0	0	0
X52	0	0	0	-0.083	0.274	0.3	0	0	0

FDI	AVE = 1.000, Alpha =0.000								
Y	1.000	0.000	-	1.000	0.000	-	1.000	0.000	-

Infrastructure	AVE = 0.761, Alpha =-0.910								
X21	0.984	0.008	120.57*	0.003	0.085	0.03	0.968	0.016	60.58*
X22	0.982	0.009	111.21*	0.282	0.097	2.89*	0.965	0.017	55.99*
X23	0.962	0.013	76.57*	0.264	0.073	3.64*	0.926	0.024	38.56*
X24	0.995	0.003	385.85*	0.227	0.112	2.02*	0.991	0.005	193.37*
X25	0.931	0.028	33.76*	0.108	0.066	1.64	0.868	0.051	17.17*
X26	0.492	0.151	3.26*	0.018	0.055	0.32	0.242	0.148	1.63
X27	0.986	0.005	195.61*	0.113	0.086	1.31	0.972	0.010	98.02*
X28	0.394	0.113	3.48*	0.050	0.046	1.07	0.155	0.092	1.69

Corruption	AVE = 1.000, Alpha =0.000								
X41	1.000	0.000	-	1.000	0.000	-	1.000	-nan	0.0

CR* = significant at .05 level

Structural Model

Path Coefficients			
	Estimate	SE	CR
Institution->FDI	-1.731	0.570	3.04*
Market Size->FDI	-0.389	0.722	0.54
Infrastructure->FDI	0.791	0.749	1.06
Corruption->FDI	0.255	0.580	0.44
Corruption->Infrastructure	0.773	0.033	23.69*

CR* = significant at .05 level

R square of Latent Variable	
Institution	0
Market Size	0
FDI	0.930
Infrastructure	0.597
Corruption	0

Means Scores of Latent Variables	
Institution	3.676
Market Size	9.930
FDI	0.823
Infrastructure	3.866
Corruption	5.727

Correlations of Latent Variables (SE)					
	Institution	Market Size	FDI	Infrastructure	Corruption
Institution	1	0.238 (0.275)	-0.911 (0.041)*	0.954 (0.020)*	0.620 (0.067)*
Market Size	0.238 (0.275)	1	-0.309 (0.331)	0.390 (0.414)	0.714 (0.710)
FDI	-0.911 (0.041)*	-0.309 (0.331)	1	-0.814 (0.068)*	-0.483 (0.075)*
Infrastructure	0.954 (0.020)*	0.390 (0.414)	-0.814 (0.068)*	1	0.773 (0.034)*
Corruption	0.620 (0.067)*	0.714 (0.710)	-0.483 (0.075)*	0.773 (0.034)*	1

* significant at .05 level

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PAGE 7

PAGE 8

PAGE 9

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PAGE 11

PAGE 12

PAGE 13

PAGE 14

PAGE 15

PAGE 16

PAGE 17

PAGE 18

PAGE 19

PAGE 20

PAGE 21
