

# **CHAPTER 1**

## **INTRODUCTION**

### **1.1 Introduction**

This chapter will be more focused on introducing and containing brief information regarding the research that are being conducted. The chapter will consist of information on the background of the research, research problem, research question, research objective, research framework, scope of key terms also their definition and the research limitation. This chapter will also explained why such research are exist and what is the motivation of the creation of the research. Such information will give the reader abundant insight to understand and reach what the research is about.

### **1.2 Background of the Study**

The world was facing a huge downturn when the COVID-19 was emerging. Back in 2019, Most of the country are issuing policies where they implore their citizen to stay at home and the policy maker are deciding to put their country in a lockdown state. Most of the activities are conducted through the online network which this new environment are deemed to be less effective than its counterpart. Such grim situation are resulting on a negative impact and the economy environment are one that negatively affected by such condition. A bad economy environment of a country can lead to a lot of calamity for their people.

On the present day, the world are still in the recovering state from the negative impact that was caused by the COVID-19. Huge cooperation between country are triggered by this condition. Humanity are at its peak where the world are started to working together, putting their desire aside and learning together on how to rebuild from such calamity. In the present economy situation and circumstances, either it is on the developed or developing country, the global economy are creating a dependency condition with each other and resulting in the forming of cooperation process in economic activity on every sector between the country. One of a very important economic component that affected heavily on the present day economic activity is investment, where it is a method of acquiring

sum of intangible asset from the available financial resources in order to maximize earnings in the future. These intangible asset are divided into two categories which direct investment and indirect investment. Indirect investment or more commonly known as portfolio investment are categorized on short term investment and deemed unstable meanwhile direct investment is a more recognized as a long term investment.

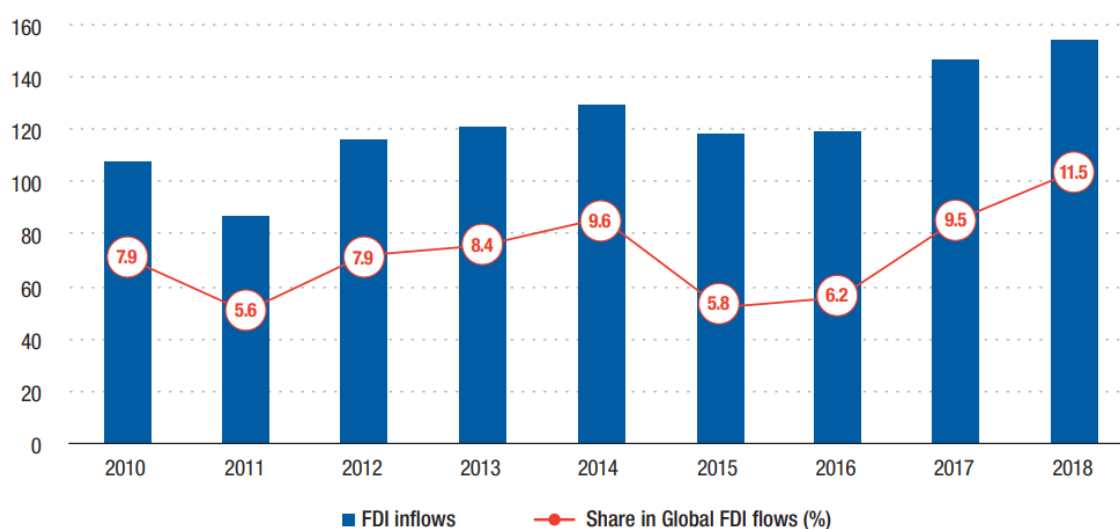
Foreign Direct Investment is a form of investment that have been conducted from the foreign country or can be said as an investment from one country to another country on the name of the capital owners (Jhingan, 2004, as cited in Rahajeng, 2014). It can be concluded that Foreign Direct Investment or FDI for short is an ownership stake in a foreign company project made by an investor, company, or government from another country. Thus, resulting FDI can help improving and maintain the sustainability of the economic growth of both country.

Foreign direct investment (FDI) has risen and become more competitive on the current era. The locomotive function of FDI in economic growth and development has been debated. It is commonly acknowledged that FDI benefits the host country's economy in a variety of ways. For example, it raises the standard of living and possibilities for economic growth, accelerates technology, improves managerial competence, and expands export markets, and these benefits exceed the downsides. This advantages are also applies with the investor which is more likely to be felt vice versa by each of the party involved. Unfortunately, it appears that the pandemic's impact on FDI flows to these economies will be very severe.

Many governments have implemented strict public health measures to curb the spread of the COVID-19 pandemic. These public health initiatives have produced serious economic disruptions, which have an impact on enterprises' foreign direct investment (FDI) decisions. Governments have also taken substantial economic policy steps to mitigate the economic repercussions of the public health problem. The ultimate impact on FDI flows will be determined by the effectiveness of both these public health and economic policy responses.

ASEAN are one of the highest recipient of the FDI in the developing world, and their FDI inflows performance are affected significantly by the emergence of such pandemic. ASEAN is a geopolitical and economic organization of Southeast Asian countries that was created in Bangkok, August 1967. ASEAN is comprising of developing countries that are still constrained in the terms of national development and resources. As a result of this scenario, they encouraged foreign direct investment as a means of financing infrastructure, economic expansion, and technology diffusion.

Back on the pre-pandemic era, FDI inflows to ASEAN was increasing for consecutive three years. The trend was predicted to continue, as a result of the region's ongoing development and strengthening of the investment and business environment. Manufacturing FDI increased across all ASEAN member countries. The majority went to Singapore, Indonesia, Viet Nam and Thailand. The growth was part of the gradual shift of production capacity from China and elsewhere to ASEAN, caused by structural factors (the increase in relative labor costs in China) and accelerated by the United States–China trade tensions.



Source: ASEAN Secretariat, ASEAN Investment Report

**Figure 1.1 ASEAN FDI Inflows pre Pandemic, 2010-2019 (Inflows Percentages)**

According to the figure 1.1, FDI inflows towards ASEAN rose by 5 per cent to a record \$155 billion in 2018. It was the third consecutive year of rising of investment in the region. Six ASEAN Member States receiving higher inflows,

one fourth (1/4) of those at record levels (Cambodia, Indonesia, Malaysia, Singapore and Vietnam). The sources of FDI have further diversified, with more companies from more countries investing in the region. But it didn't take long since the global economic are disrupted by the emergence of the COVID-19. Due to the unprecedented impact of COVID-19 pandemic, FDI inflows of ASEAN states on 2020 (ASEAN Secretariat, 2021).

Foreign Direct Investment (FDI) are one of the sector that impacted heavily due to the condition that was created by the COVID-19. Most of the FDI inflows activities are coming to a halt and facing recession. On facing the recession of the inflows, it must be put into the consideration that the macroeconomic factors must be playing a significant role on such situation. It is caused by macroeconomics factors explains how economic changes affect numerous parties, including society, businesses, governments, and the foreign sector (Kuncoro, 2009, as cited in Rahmawati, 2022). According to several empirical studies, stronger economic growth leads to more FDI inflows into host nations. Also, Markowski and Jackson's 1995 study (as cited in Prinivasan, Kalaivani and Ibrahim, 2011) discovered that economic growth had a beneficial effect on FDI inflows into various Asian countries.

This resulting on macroeconomic factor indeed playing an important role on FDI Inflows and one of the inseparable from macroeconomic factors. Macroeconomic movement and volatility will affect on the interest of the investor thus resulting on the continuity of the FDI inflows. This are supported by Keynes opinion on investment where the investment is determined by the interest rate, usage fee, and predicted profit. The MEC (Marginal Efficiency of Capital) profit rate is the level of net profit expected return on incremental capital expenditures. However, Keynes also proposed that interest rates are not the only factor influencing investment. Another factor influencing investment is the economic environment.

### **1.3 Problem Statement**

FDI could play a significant role in assisting economies through the economic recovery following the pandemic. Evidence from previous crises shows

that foreign-owned affiliates, including small and medium enterprises, can show greater resilience during crises due to their links with, and access to, their parent companies' financial resources (Alfaro & Chen, 2012; Desai et al., 2008, as cited in Rahmawati, 2022). Given that other sources of international capital, notably portfolio investment, have departed these economies, FDI could be especially crucial for rising and developing economies.

The Organization for Economic Cooperation and Development (OECD) stated that even in the most optimistic scenario for the achievement of governments' public health and economic assistance policy actions to confront the COVID-19 pandemic and resulting recession, FDI flows are anticipated to plummet by more than 30% in 2020. they also stated that, the FDI flows to developing nations are projected to fall even more because industries significantly damaged by the epidemic, such as agriculture and manufacturing, account for a bigger part of their FDI than in developed economies, but such statement seems not particularly true specifically in ASEAN States.

**Table 1.1. Data of FDI Inflows Activities During-Post Pandemic, 2019-2021 (Million US\$)**

Host Country	Year			
	2018	2019	2020	2021
Brunei Darussalam	517.3	374.6	577.4	204.8
Cambodia	3,212.6	3,663.0	3,624.6	3,483.5
Indonesia	20,563.5	23,883.3	18,591.0	20,081.2
Lao PDR	1,358.0	755.5	967.7	1,071.9
Malaysia	7,611.3	7,859.7	3,185.3	11,593.9
Myanmar	1,609.8	1,729.9	2,205.6	1,005.0
Philippines	9,948.6	8,671.4	6,822.1	12,412.6
Singapore	73,917.6	106,319.8	75,466.2	99,061.5

Thailand	13,751.8	5,518.7	-4,951.0	14,640.9
Viet Nam	15,500.0	16,120.0	15,800.0	15,660.0
Grand Total	147,990.4	174,895.9	122,288.9	179,215.3

*Source: ASEAN Secretariat, ASEAN Investment Report*

In responses to the global pandemic situation, ASEAN Member States are continuing to adopt new facilities and policies. One example is the ASEAN Investment Facilitation Framework, which was established in 2021, and the implementation of new investment facilitation measures to assist investors. The RCEP Agreement, signed in 2020, was ratified in 2022, with significant ramifications for the region given ASEAN central role in this economic bloc. The RCEP Member States account for 30% of global GDP, exports, and FDI flows, and are both important home and major host nations for numerous multinational corporations.

According to the table 1.1, back in 2019 ASEAN are having a positive inflows from the previous year and was known as the growing power in the east, also FDI Inflows reaches its highest level at US\$ 182 billion making ASEAN the largest recipient in the developing world. Due to the unprecedented impact of COVID-19 pandemic, FDI inflows of ASEAN states on 2020 are facing a recession and manage to recover from the impact. At 2021, ASEAN recorded a robust rebound in FDI Inflows where it's surging by 42% from the last year. In the phase of recovery from facing the COVID-19 pandemic the FDI inflows into the ASEAN region have grown steadily over the past decade, albeit temporarily disrupted during 2020 due to the pandemic. The question are arose, how can such community can manage to rebound from such recession and managed to quickly stabilized their FDI Inflows ?

Busari (2006, as cited in Rahajeng, 2014) argue that, there are tow indicator on how to measures the foreign investment inflows volatility. First indicator is based on the macro economy sector of a country such as GDP, Fiscal Policy, Inflation, Exchange Rate. The second indicator are based on the government quality itself. On the other hand Agung (2014, as cited in Rahajeng,

2014) analyse on how GDP, Debt and Openness affecting the FDI Inflows which Agung uses data from eight countries which consist of India, Indonesia, South Korea, Malaysia, Mexico, Philippine, Thailand, and Turkic on the period of 2000-2010. GDP and Openness have a significant impact towards the FDI Inflows, on the other hands Debt have a negative impact towards the FDI inflows.

This study are mainly focusing on analyzing what factors that can affecting interest of the investor since investor obviously did not want to make a poor investment decision country thus resulting this study will be more focused on the scope of on which area will affect FDI inflow towards each of the ASEAN states. There are many factor that can influence the inflow of FDI to the host country. thus resulting in intriguing area for the research in examining how GDP, Inflation Rate, External Debt, and Interest Rate are affecting the FDI Inflows of each State of ASEAN Country

## **1.4 Research Objectives**

### **1.4.1 General Objective**

The study conducted within this paper is to aim and analyzing on how the related variables of macroeconomic factors that can affects the Foreign Direct Investment (FDI) inflow and giving an insight regarding their influences towards FDI Inflows on each of the ASEAN States.

### **1.4.2 Specific Objectives**

The specific objectives of this research seek to prove the effect of macroeconomic factors that influence on foreign direct investment inflow:

- RO1 : To examine the influence of each ASEAN States Gross Domestic Product (GDP) on FDI inflows of each States member.
- RO2 : To examine the influence of each ASEAN States inflation rate on FDI inflows of each States member.
- RO3 : To examine the influence of each ASEAN States external debt on FDI inflows of each States member.
- RO4 : To examine the influence of each ASEAN States interest rate on FDI inflows of each States member.

## **1.5 Research Questions**

The study conducted within this paper aims to solve these following research question that are revolving around the studies:

RQ1 : What is the Gross Domestic Product impact towards the FDI Inflows of ASEAN States?

RQ2 : What is the Inflation Rate impact towards the FDI Inflows of ASEAN States?

RQ3 : What is the External Debt impact towards the FDI Inflows of ASEAN States?

RQ4 : What is the Interest Rate impact towards the FDI Inflows of ASEAN States?

## **1.6 Significance of the Study**

The significance of this study are refers to the contribution and impacts by this specific macroeconomic study that have been conducted by the author. The significance will spark a signal to every stakeholder that are interested on such study that have been conducted. The author are targeting on the interest of future researcher where they can conduct further study and making this research as their main starting point. In hope that future researcher will update the information so that it will have a more relevant result and approach. The other stakeholder that are being mentioned are the policy maker or the government where they are plating an important role on the economic cycle of their country.

### **1.6.1 The Researchers**

The researcher here are comprises of academic society (students, lecturer and scholar) alike and any stakeholder that have interest towards the research that have been conducted to conduct a research based on this study. The researcher can use the result of this study as the starting point and source of information that can be useful for them to use in the future research.

The condition of macroeconomic specifically the FDI inflows and macroeconomic factors are fluid and volatile. This is proof by the variation of the factors and variables that can affect FDI inflows and different events that occurred



on each years. Such situation will resulting on the different needs and different factor on each year that may affect on the changes on the scope of study. This also resulted by the different of point of view of the researcher that scattered all around the world where there will always be a gap on the study that can be explored more. Thus the author of this study are hoping that the study will give a significant influence for the future researcher through process and the result of the study.

The result of the study that are being conducted within this paper are also aiming to help the future researcher to gain an insight, so that the future researcher with the same interest on the condition of the economic growth specifically on the Foreign Direct Investment inflows (FDI) and related study on Gross Domestic Product (GDP) can continues this study and closing a new gap in the future condition that are not relevant anymore with the conducted study.

### **1.6.2 The Policy Makers**

The policy makers here are mostly focusing on the state, local, central and any type of government who have interest and considered as stakeholder towards the research that have been conducted to conduct a research on helping them to finding a specific information that based on this study. The policy makers can use the result of this study as the starting point and source of information that can be useful for them to use in the future decision making and finding important factors on each FDI inflows on their territorial that they governed.

The result of the study that are conducted within this paper are expected to inform the policy makers or the government on what should they manage and helping them to giving an insight regarding on what is the expected policy that they should and can implement on the macroeconomic factors that may or will affect the FDI Inflows towards their country no matter what they are facing or the condition around the world.

### **1.7 Scope of the Study**

The scope of study's population consists of all of the recognized and listed member of the ASEAN States from 2010-2021, in total of 10 ASEAN States

member. Purposive sampling are the sampling method that are being used to conduct this study. Thus in order to determine the related sample for the study, specific criteria are devised for selecting data that met the requirement of the study. Based on the criteria 6 countries of the ASEAN States member are chosen as the research sample.

### **1.8 Limitations of the Study**

Research on macroeconomic area can lead into a huge amount and wide variety of area that can be explored. Such situation can led into deviation of the titles. This will also increasing the difficulties to focusing on conducting the research where that is resulted by huge amount of factors. Thus the limitation of research are needed to conduct this study regarding the macroeconomic factors that can affect FDI inflows on each ASEAN States.

In the accordance with the background of the research that has been mentioned, there are a huge range of issue that can be arises when determining what macroeconomic factors that may or will affecting the FDI Inflows. In this case the study will be more focus on how the GDP, Inflation Rate, Foreign Debt and Interest Rate affects FDI Inflows where the variables are resulted from the past literature and inspired also adapted from past various research.

ASEAN States member consist of 10 legitimate and recognized member. To avoid The data confusion and to filter the subject that are being researched, it would be revolve and more focusing around 6 ASEAN States which comprises of Cambodia, Indonesia, Malaysia, Singapore and Vietnam where these nation are considered as top 6 receiver of the FDI inflows of the ASEAN States member.

Wide range of period will also put into consideration where the period of research are playing an important role on it, since the research are focused heavily upon the FDI inflows movement of ASEAN States and the rebound phenomenon that was occurred by the occurrences of the COVID-19. The author are trying to make a relevancy with the event where the period of research will be set in the circa 2010-2021 which the set of period are still in the range of where the stakeholder can see how much the FDI inflows progress before, during, and post COVID-19

## **1.9 Definition of Key Terms**

### **1.9.1 Foreign Direct Investment**

Foreign Direct Investment is a form of investment that have been conducted from the foreign country or can be said as an investment from one country to another country on the name of the capital owners (Jhingan, 2004, as cited in Rahajeng, 2014). FDI categorized as cross-border investment in which a resident of one economy establishes a long-term interest in and substantial influence over a resident of another economy.

### **1.9.2 Gross Domestic Product**

GDP measures the monetary value of final goods and services produced in a country in a given period of time, where it counts all output generated within the country's borders because it is composed of goods and services produced for sale in the market and also includes some non-market production such as defence or education services provided by the government. (Callen, 2019, as cited in Rahmawati, 2022).

### **1.9.3 Inflation Rate**

Inflation is one of the measure that might describe a country's economic stability. A high inflation rate suggests internal economic instability; it signifies that the government is unable to balance the economy and that the central bank has failed to implement appropriate monetary policy. Companies experience price and input price unpredictability as a result of the high inflation rate. Thus under such conditions, multinational corporations will avoid or restrict investment in nations with high inflation rates. (Dhakal et al., 2007, as cited in Rahajeng, 2014).

### **1.9.4 Foreign Debt**

According to Todaro (2000, as cited in Rahajeng, 2014), Foreign debt refers to all government loans and aid in the form of money or goods that are primarily designed to move resources from rich countries to developing countries, with the ultimate goal of development and income distribution. Foreign finance sources (grants and loans) play an essential role in efforts to supplement a lack of local resources in order to accelerate the growth of foreign exchange and savings.

### **1.9.5 Interest Rate**

According to Kasmir (2002, as cited in Rahajeng, 2014), interest rate are payments made by banks to consumers who buy or sell using conventional principles. Customers can earn two types of interest: deposit interest and interest loan interest. Deposit interest is paid as an incentive to save money in a bank, whereas loan interest is given to the borrower or the price to be paid by the borrower's client. Because the two types of interest are mutually exclusive, if the interest on deposits is high, the interest on loans will automatically rise, and vice versa.

### **1.10 Chapter Summary**

In brief this chapter revolving on every important background information regarding the study. This chapter are consist of the information on the background of the research, the research problem, research objectives, research question, significance of study, scope of study, limitation of study, definition of key terms and structure of the proposal. As a result, it will be easier for the reader to comprehend the motivation behind this study.