Political stability and FDI in the most competitive Asia Pacific countries

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Abstract

Purpose – Competitiveness is vital to attracting FDI into a country, which has led us to investigate the determinants of FDI in the top 15 most competitive countries in the Asia Pacific region.

Design/methodology/approach – We have analysed political stability alongside other commonly studied determinants of FDI. We have employed a panel data fixed-effect model on a 14-year sample data (2000-2013) involving the top 15 most competitive Asia Pacific countries. The Global Competitiveness Index was taken as the yardstick to identify these countries. We have used fixed effect, GMM-system, and Panel ARDL tests for robust results.

Findings – The GDP, trade openness and political stability positively influenced FDI inflows while inflation rate negatively impacted FDI inflows in the selected countries. Political stability was the most influential variable in the presence of other indicators. GDP, openness, and political stability exhibit significant long-run relationship with FDI inflows.

Research limitations/implications – To increase FDI flows, regulators should focus on building the image of the country, and possibly the region, by ensuring stable economic and political environment, maintaining macroeconomic stability through bi- and multi-lateral arrangements with neighbouring countries.

Originality/value – Regional relationships with neighbouring countries can be considered as the building blocks for attracting FDIs. These relationships can be strengthened based on liberal trade policies, openness in capital control, and cooperation in terms of political actions. One such recent issue in regional political cooperation include actions to reduce terrorism and corruption that help boost the confidence of the investors.

Keywords Asia Pacific, GMM, Fixed-effect, Political stability, Panel ARDL, FD

Paper type Research paper

1. Introduction

According to UNCTAD, Foreign Direct Investment (FDI) is referred to as:

> A long-term investment relationship that shows commitment and ownership by a native entity in an economy (foreign direct investor or parent enterprise) of a firm in a separate economy (FDI enterprise or foreign affiliates).

The effects of FDI on the host country's economy are innumerable, which help enhance the welfare of the country. FDI has also become increasingly essential for stronger capital flows, a key source of income, transfer of new technology and management practices, business competition, job creation, formations of international marketing networks, innovation as well as skill enhancement (Xaypanya *et al.*, 2015; Takii, 2009). With the increased globalisation over the last several decades, there has been a significant rise in FDI flows across countries. According to United Nations Conference on Trade and Development

JEL classification – F21, C23, F50

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(2014), global FDI has gained significant growth again after a slump in 2012, with 9 per cent increase in FDI inflows during 2013, which has risen to $1.45 trillion having the emerging countries leading the change. According to UNCTAD, the inflows of FDI are projected to increase to $1.8 trillion in 2016 that are mostly involving the developed countries. However, the expected upturn in FDI may be negatively affected by the fragility in several developing markets, excessive political uncertainty, and overall regional instability (United Nations Conference on Trade and Development, 2014).

The motivation of this paper is to examine the determinants of FDI by analysing the top 15 performers in the Asia-Pacific region as shown in Table I above. In a fast-moving technological world, it is crucial to creating a competitive environment in order to attract a substantial amount of FDI inflows (Porter, 1990). The relationship between competitiveness and FDI is bilateral where the competitiveness of a host country can be improved by FDI. In order to attract ample sum of FDI, the host country needs to be competitive in the first place. Countries' competitiveness is driven by numerous factors. According to the Global Competitiveness Report 2014-15 by World Economic Forum (2014) the countries' competitiveness is ranked by global competitiveness index that is based on 12 pillars of competitiveness including infrastructure, market size, institutions, high education and training, health and primary education, business sophistication, technological readiness, macroeconomic environment, labour market efficiency, financial market growth, goods market efficiency, and innovation. One of the highlights of the report is that the Asian Tigers continue to display strong performance. The FDI trend of the top 15 performers in the Asia-Pacific region is presented below (in Figure 1 and 2) by categorizing them into developed and developing countries. Table II summarises the key developments in the selected Asia Pacific countries.

The analysis in this study is based on a panel regression model that combines time series and cross-sectional data where data of 15 countries from 2000 to 2013 are employed to examine the drivers of FDI inflows. Furthermore, this study looks at both developed and developing countries. Three important findings of this study make significant contributions to the existing body of research. Firstly, this paper aims to look at how competitive are these countries' in attracting FDI. Secondly, the sample period is updated to complement the existing literature.

	2014-2015		2013-2014	
Country	Rank (out of 144)	Score	Rank (out of 148)	Score
Australia	22	5.08	21	5.09
China	28	4.89	29	4.84
Hong Kong SAR	7	5.46	7	5.47
India	71	4.21	60	4.28
Indonesia	34	4.57	38	4.53
Japan	6	5.47	9	5.40
Korea, Rep	26	4.96	25	5.01
Malaysia	20	5.16	24	5.03
New Zealand	17	5.20	18	5.11
Philippines	52	4.40	59	4.29
Russian Federation	53	4.37	64	4.25
Singapore	2	5.65	2	5.61
Thailand	31	4.66	37	4.54
Turkey	45	4.46	44	4.45
Vietnam	68	4.23	70	4.18

Source: World economic forum, available at: www.weforum.org/gcr

Table I. The global competitiveness index ranking

Thirdly, this paper aims to analyse a framework that is more comprehensive where the roles of the market, economic, political and institutional factors are used as possible determinants of FDI. Political stability, which has been given lesser importance in extant studies, is included in order to ascertain its influence on FDI in the presence of other variables.

The remaining of the study is organized as follows: Section 2 discusses the FDI determinants from past literature; data and methodology are presented in Section 3; Section 4 discusses the findings and analysis, and Section 5 concludes the report.

2. Literature review

The classical model that explains the determinants of FDI is initiated from Dunning's (1980) earlier research in his varied theory of FDI where a thorough analysis grounded on ownership, location and the internalisation (OLI) paradigm. In OLI theory, there are four categories of FDI - market-seeking FDI, efficiency seeking FDI, resource seeking FDI, and strategic asset seeking FDI. Penetration of the domestic markets of the host countries is the aim of market-seeking FDI and it is commonly related to domestic market growth whereas the resource-seeking FDI look at natural resources in a country, for instance, available raw materials, cheaper labour force supply, the level of technology, and physical infrastructure. Competitiveness of firms is the motive in efficiency-seeking FDI while strategic asset-

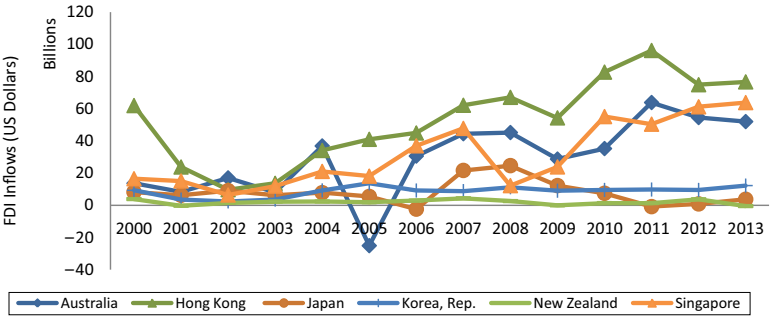

Figure 1.
Trends of FDI inflows in developed Asia-pacific countries

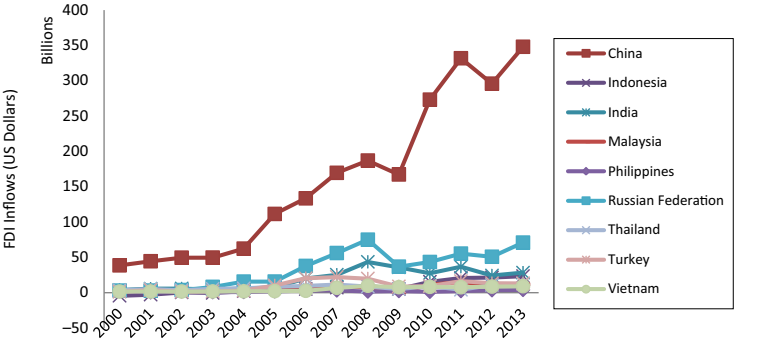

Figure 2.
Trends of FDI inflows in developing Asia-pacific countries

Countries	Highlights
Australia and New Zealand	The drop of 12% is observed in the FDI Inflows to Australia and New Zealand together. It declined to $51 billion in 2013. This is due to the halved sales of M&A in Australia
China	Since 2012, FDI inflows to China have slowly regained growth. In 2013, China gains FDI inflows of $124 billion, with a major increase in services and so, China came to be ranked as second in the world once again. The gap with the largest host country in the world, the United States, is further narrowed
Hong Kong	Hong Kong's FDI inflow has increased by 2 per cent to $77 billion. It is reported that Hong Kong experienced a relatively slow growth in FDI inflows. Although $77 billion is still below the record level of $96 billion in 2011, it is still higher than the three-year averages before the crisis ($49 billion) and after the crisis ($68 billion). Nonetheless, it is the second largest FDI recipients in developing Asia
India	India is the leading recipient of FDI in South Asia. India has experienced a 17% growth of FDI inflows in 2013 to $28 billion. Although India's FDI inflows rose, its macroeconomic uncertainties remain a major concern to the foreign investors
Indonesia	Among the ASEAN member States, Indonesia was most influenced by the financial turmoil of developing economies in mid-2013. Nevertheless, Indonesia's FDI inflows remained stable around $18 billion
Japan	It is reported that FDI inflows to Japan increased by 61% to $2.8 billion, mainly due to an upturn in M&A sales resulting from ownerships to a number of mega deals. For instance, United States–based Micron Technology Inc.'s merger with Elpida Memory Inc. for $2.5 billion
Korea	Inflows to the Republic of Korea reached $12 billion in 2013, its highest level since the mid-2000s. This is credited to the rise of FDI in the shipbuilding and electronics industries in which the country enjoys strong international competitiveness as well as in the utility industries
Malaysia	Malaysia, as another huge FDI recipient among ASEAN members, seen rising FDI inflows by 22% to $12 billion. This is attributed to increasing FDI in their services sector
Philippines	Reaching the highest level in its history, Philippines's total FDI inflows rose by one-fifth to $4 billion. Its FDI inflows were not affected by typhoon Haiyan in 2013
Russia federation	The FDI inflows to transition economies are increased by 28%, achieving $108 billion in 2013. This is mainly driven by the significant growth of FDI to the Russian Federation. 57% growth in FDI inflows is reported in the Russian Federation, attaining $79 billion. As a result, they became the third largest recipient of FDI in the world for the first time
Singapore	As the third largest FDI recipient in developing Asia, Singapore experienced the increase in annual FDI inflows above $60 billion in 2012 for the first time. The FDI inflows to Singapore reached a record high of $64 billion in 2013 due to a number of megadeals in 2013, such as the acquisition of Fraser & Neave by TCC Assets for about $7 billion
Thailand	In Thailand, FDI inflows grew to $13 billion. However, about 400 FDI projects were shelved in reaction to the continuing political instability. The prospects for FDI inflows to the country remain uncertain
Turkey	Turkey continues to be the main FDI recipients in West Asia 2013, despite the slightly reduced inflows. In 2013, its FDI inflows are close to $13 billion which remained at almost the same level as the previous year. This is related to the cross-border M&A sales, which dropped by 68% to $867 million, their lowest level since 2004
Vietnam	Vietnam maintained its position at almost the same level as previously. Notably, Japanese companies are attracted by the low labour costs and good growth prospects of Vietnam. Japanese investment in Vietnam has increased from about $1.8 billion in 2011 to $4.4 billion investments being approved in 2012

Note: All dollar amounts are in USD
Source: Compiled by the authors from the United Nations Conference on Trade and Development, 2014

Table II.
Highlights of each country's FDI inflow/ performance

seeking FDI focuses on transforming company's global or regional strategy into foreign networks of assets like technology, organisational abilities, and markets (Faeth, 2009). There is voluminous empirical literature that reports a mixed bag of determinants of FDI. However, due to diverse choices of countries, time periods and methodology applied, the existing empirical evidences are overly simplified. Table III summarizes the relationship between FDI and its explanatory variables based on existing researches.

With reference to the previous empirical studies, five most important determinants of FDI inflows are discussed further in the following sections. These are political stability, domestic market size, growth prospects, trade openness, and macroeconomic stability:

(1) *Political stability*: A country's political risks is a crucial factor considered by foreign investors (Moosa, 2002). Political risk is connected to seizure or damage to property, production disruption, threats to personnel including operational restrictions that impede the investors' ability in undertaking certain actions, riots, and changes in regulatory environment or the macroeconomic management (Daniels *et al.*, 2002). Investors will not invest and risk their capital in an unstable environment. Jadhav (2012) and Kariuki (2015) have presented inconclusive findings on the impact of political stability on FDI, which has led to the investigation of political stability to understand its impact on FDI inflow in the context of Asia Pacific countries. Corruption that is politically motivated significantly reduces FDI inflows in selected Asian countries (Woo and Heo, 2009);

(2) *Growth prospects*: Higher growth of market implies that there exists potentially a higher production opportunity in the domestic market. A country that has consistently positive growth rates along with a stable macroeconomic condition is likely to attract more FDI as compared to a country that has reported a volatile economy. As a result, foreign investors would prefer to make an investment in a growing economy that reflects more opportunities to generate profit (Nonnenberg and Mendonca, 2004);

(3) *Market size*: Although growth may be a vital input, the inherent size of the market is another important determinant. A bigger consumer market indicates a greater amount of consumption that translates into more opportunity for the trade of goods and services. Hence, the common inference is that countries with a larger local market size or greater economic growth tend to attract more market-oriented FDI (Ang, 2008);

(4) *Trade openness*: A host country with better trade facilities and liberal policies is often preferred by investors. For instance, export-oriented MNCs would be more inclined to invest in a more open economy due to the incurrence of higher transaction cost that is related to the export in countries with trade protection (Sahoo, 2006). Furthermore, FDI and trade volumes are positively connected, which presents that the host countries need to improve their trade activities if they wish to attract more FDI; and

(5) *Inflation rate*: Excessive inflation rate indicates macroeconomic instability and larger risk for foreign investors. A high inflation rate also represents the internal economic tension, which explains the unwillingness or inability of the government and the central bank to balance its budget and restrict money supply. Consequently, the higher the inflation rate, the more deterred foreign direct investment decision-makers are from engaging with the country. Hence, a negative relationship is expected (Nunes *et al.*, 2006).

Table III.
Summary of the empirical studies about the determinants of FDI

Study	Context	Period	Impact on FDI		
			Positive	Negative	Insignificant
Cheng and Kwan (2000)	China	1985-1995	Regional income Infrastructure Policy designations	Wage cost	Education level
Yusop and Choong (2002)	Malaysia	1965-1999	GNP	Current account deficit Inflation	Exchange rate, Interest rate differential Uncertainty
Garibaldi, Mora, Sahay and Zettelmeyer (2002)	26 transition economies in Eastern Europe including the former Soviet Union	1990-1999	Market size Economic reforms Trade openness Natural resources Bureaucracy	Fiscal deficit Inflation Exchange rate regime, Risk analysis Barriers to investments	
Ismail and Yussof (2003)	Malaysia, Thailand, and the Philippines	1985-1999	Market size, openness		Manufacturing wage rate
Kinoshita and Campos (2003)	25 transition economies	1990-1998	Market size Natural resources Trade Openness	Labour cost Restrictions	
Nonnenberg and Mendonça (2004)	38 developing countries	1975-2000	Level of schooling Trade Openness Growth Rate Stock Market Performance	Risk Inflation	
Nunes, Oscategui and Peschiera (2006)	Latin American	1991-1998	Market Size Trade Openness Inflation Infrastructure Human Capital Natural Resources	Wage rate	
Sahoo (2006)	South Asian countries	1970- 2003	Market Size Labour Force Growth Infrastructure Index Trade Openness		
Moosa and Cardak (2006)	138 countries	1998-2000	Exports as a percentage of GDP Telephone lines per 1000 of the population Country risk		Growth rate of GDP Commercial energy uses per capita Domestic gross fixed capital formation

(*continued*)

Table III.

Study	Context	Period	Impact on FDI Positive	Negative	Insignificant
					Students in tertiary education
Choong and Lim (2007)	Malaysia	1970-2001	Market Size Skilled labour Liberalization	Competitor's market size	
Cevis and Camurdan (2007)	17 developing countries	1989-2006	Interest rate Growth Trade openness Previous period FDI	Inflation rate	GDP growth Wage Domestic Investment
Cevis and Camurdan (2009)	17 developing countries	1989-2006	Trade Openness	Inflation Interest rate	
Azam (2010)	Bangladesh, India, Pakistan, Sri Lanka	1980-2009	Exports		
Vijayakumar, Sridharan and Rao (2010)	BRICS countries	1975-2007	Market size Infrastructure Gross Capital Formation	Labour cost Currency value	Economic Stability Growth (inflation rate and industrial production) Trade Openness
Lipsey *et. al.* (2010)	Indonesia	1985-2005	GDP, Per Capital Growth	Poor business environment, poor institutional quality	
Ranjan and Agrawal (2011)	BRICS countries	1975-2009	Market size Trade openness Infrastructure facilities Macroeconomic stability Growth prospects	Labour cost	
Kirchner (2012)	Australia	1989-2004	Economic growth Productivity growth	Foreign portfolio investment Trade Openness Exchange Rate Foreign real interest rate	Gross capital formation Labour force
Jadhav (2012)	BRICS countries	2000-2009		Natural Resource	Inflation rate Political Stability/No

(*continued*)

Study	Context	Period	Impact on FDI		
			Positive	Negative	Insignificant
			Market size Trade Openness Rule of law, Voice and Accountability		violence Government Effectiveness Regulatory Quality Control of corruption
Hoang and Goujon (2014)	Vietnam	The period after the Asian crisis	Market size Infrastructure		Land cost
Xaypanya et.al. (2015)	Cambodia, Laos, Vietnam Indonesia (Asean3) Malaysia, the Philippines, Thailand, and Singapore (Asean5)	2000-2011	ASEAN3: infrastructure facility Trade openness ASEAN5: Market Size Infrastructure facility Trade openness	Inflation	Real exchange rate Gross domestic product Net official development assistance
Dua and Garg (2015)	India		Domestic returns Domestic output Infrastructure Creditworthiness	Exchange rate Macroeconomic instability Trade Openness Global FDI flows to other emerging economies	
Kariuki (2015)	35 African countries	1984-2010	Commodity price index performance Good performance of stock market Infrastructure Trade Openness	Economic risk	Political risk Financial risk
O'Meara (2015)	Large sample of both developed and developing countries	2001-2010	GDP Labour force Broadband penetration		Economic freedom Tax incentives Human capital

Source: Compiled by the authors for this study

Table III.

3. Data and methodology

The study examines the determinants of FDI inflows of the top 15 competitive countries from the Asia-Pacific region based on the Global Competitiveness Report 2014. The countries that are included in the analysis are Australia, China, Hong Kong, Indonesia, India, Japan, South Korea, Malaysia, New Zealand, Philippines, Russian Federation, Singapore, Thailand, Turkey and Vietnam. The study considers a time horizon of fourteen years from 2000 to 2013. All the data are sourced from the World Bank's website.

A panel data model is employed, which offers a combination of the characteristics of the time-series and cross-section components for the most reliable estimates in this kind of scenario. Panel data technique examines the FDI with respect to all the determinants by taking into consideration the annual changes in FDI of different countries. Thus, the parameters can be estimated and discussed more efficiently (Baltagi and Kao, 2000).

The dependent variable is the natural logarithm of annual FDI inflows. This study includes five independent variables, namely the domestic market size, trade openness and growth as economic factors, macroeconomic stability as the probable institutional determinants, and political stability to uncertainty related to the political condition of the country. These determinants are chosen due to the relative significance of each variable in existing empirical literature. Table IV offers the details of the data used in this study. Following the table is the regression model that has been tested in this study.

A panel data even with significantly large cross-sectional component may suffer from cross-sectional dependency and serial correlation (Kim, 2010). We follow the suggestions presented in recent empirical literature to conduct Panel ARDL and Dynamic GMM models to solve these problems (Pesaran *et al.*, 1999; Arellano and Bond, 1991). We have offered summary results of the various estimations to get to a robust conclusion:

Variable	Definition	Formula	Reason	Expected effect
GDP	The monetary value of all the finished goods and services produced within a country's borders in a specific time	Real GDP	To capture the changes of goods and demands. As a proxy for domestic market size, it provides a representation of the market size hypothesis	Positive
Growth of GDP	The change in GDP by comparing with the previous year	Growth rate of GDP	A predictor of the future size of the host country's market which indicates rising productivity and profitability	Positive
Trade Openness	The removal or reduction of or barriers to the free exchange of goods between nations	The sum of export and import over GDP	An indicator of the level of liberalization of the trade policy of a country	Positive
Inflation Rate	The percentage rate of change of a price index over time	Inflation rate (consumer prices)	Indicates a country's macroeconomic risk	Negative
Political Stability	The durability and integrity of a current government regime	Political Stability Index	Indicates a country's political risk	Positive

Source: Look into world development indicators by world bank for more information on the variables

Table IV. Summary of independent variables

$$LNFDI_{it} = \alpha + \beta_1 LNGDP_{it} + \beta_2 GRO_{it} + \beta_3 OPEN_{it} + \beta_4 INF_{it} + \beta_5 POL_{it} + \varepsilon_{it}$$

where:

$LNFDI_{it}$ = Natural logarithm of FDI inflows of country i at time t
$LNGDP_{it}$ = Natural logarithm of real GDP of country i at time t
GRO_{it} = Growth rate of GDP of country i at time t
$OPEN_{it}$ = Trade openness of country i at time t
INF_{it} = Inflation rate of country i at time t
POL_{it} = Political stability of country i at time t
ε_{it} = Disturbance term of country i at time t
α = Intercept
β_1 to β_5 = Estimated coefficients of the independent variables.

4. Empirical analysis

Table V provides the descriptive statistics that comprises of mean, standard deviation, skewness, and kurtosis. To determine the range and coverage of the data, mean and standard deviations are presented, whereas *skewness* and *kurtosis* help to determine a violation of normality assumption.

There is high economic growth, an average of 5 per cent, in the 15 most competitive countries in the Asia Pacific region. However, the wide range and high standard deviation suggest that the economic growth varies among the countries; as some countries exhibiting excessively higher growth value while others suffer from severe contraction. Meanwhile, the sample also demonstrates high average inflation rates and trade openness. Unlike growth, relatively lower median, high standard deviation and the wider range of inflation rate and trade openness suggest some degree of differences amongst the countries. Only trade openness is positively skewed, which is anticipated due to the non-negative nature of the measure. However, the kurtosis of both trade openness and economic growth is in excess of three signifying that they are leptokurtic and have higher probabilities of extreme values. Therefore, trade openness and growth may not follow a normal distribution. However, the sample size may help us meet the conditions of the central limit theorem.

On the other hand, the measure of political stability shows an average close to zero, which implies that the sample contains countries mixed with good and weaker political governance. This observation is interesting as one should expect top countries to have relatively superior governance, which enables them to remain competitive. Yet,

Items	LFDI	LGDP	OPEN	GRO	INFRATE	POL
Mean	23.103	22.338	1.221	5.125	5.008	−0.086
Median	22.974	22.347	0.650	5.215	3.526	0.105
Maximum	26.575	25.144	4.583	15.240	54.915	1.474
Minimum	18.557	20.323	0.203	−7.820	−3.692	−2.118
SD	1.424	1.212	1.157	3.276	6.421	0.986
Skewness	−0.071	0.391	1.647	−0.459	0.423	−0.111
Kurtosis	3.123	2.154	4.479	4.688	2.914	1.632
Observations	188	188	188	188	188	188

Notes: LFDI – Natural log of FDI inflows; LGDP – Natural log of GDP; OPEN – Trade openness; GRO – Growth; INFRATE – Inflation rate; POL – Political stability

Table V. Descriptive statistics

descriptive statistics suggest that our sample of top countries also include countries with low political stability. Nevertheless, they are consistent with the notion of normality of data with a mean and skewness close to zero and a kurtosis well below three. We report the correlation coefficients in Table VI to understand about the possibility of multicollinearity.

This is further supported by a test of multicollinearity, which is the variance inflation factor, to identify the severity of multicollinearity. A value larger than 10 indicates a potential multicollinearity problem. As shown in Table VII below, the variance inflation factors of all the variables are low. When compounded with the low and insignificant correlations presented earlier in Table VI, there is a no possibility of multicollinearity issue.

Hausman Specification Test is carried out to determine the appropriate model. Table VIII below shows that a fixed effect model is preferred as the null hypothesis of a more efficient random effect model is rejected at 1 per cent significance level.

Table IX presents a summary of the regression outcomes based on four different tests:

Variables	LNFDI	LNGDP	GRO	OPEN	INF	POL
LNFDI	1.0000	0.4822	0.2300	0.0848	−0.1610	0.1452
LNGDP		1.0000	0.0307	−0.6593	0.0535	−0.1525
GRO			1.0000	0.1092	0.0243	−0.2522
OPEN				1.0000	−0.1603	0.2988
INF					1.0000	−0.3636
POL						1.0000

Table VI.
Correlation matrix

Notes: Pearson correlation is carried out; the number of observations is 188; all the correlations are insignificant at one and two tailed tests

Dependent variable: LNFDI	
Independent variables	Variance inflation factor
LNGDP	1.823
GRO	1.160
OPEN	2.067
INF	1.169
POL	1.345

Table VII.
Results of variance inflation factors

Note: VIF(i) = 1/(1 − R(i)^2), where R(i) is the multiple correlation coefficient between variable i and the other independent variables. Minimum possible value = 1.0. Values > 10.0 indicate a collinearity problem

Test summary	Chi-Square statistic	Chi-Square DF.	Probability
Cross-section random	31.049074	5	0.0000***

Table VIII.
Hausman test

Notes: The results above are obtained after applying Hausman Test. Statistically significant at: *** = 1 per cent level

(1) fixed effect in cross-section;

(2) fixed effect in cross section and period with White cross-section adjustments, and corrections of standard error and covariance;

(3) Generalised Method of Moments (GMM) system at first difference with White-period instrument weights, and White-period correction of standard error and covariance; and

(4) Panel Auto Regressive Distributed Lags (ARDL) with automatic lag selection based on Akaike Info Criteria (AIC).

For Model (4), we have only presented the long-run estimates, the co-integrating vector coefficient is presented in the note.

Across the four models tested in this study, we have found consistent positive impact of GDP, openness, and political stability on the inflow of FDI, and a consistent negative impact of inflation rate on FDI inflows in the selected Asia Pacific countries. GDP growth, which is used as an indicator of market potential, has been insignificant in all the models. Unlike the existing studies (Chakrabarti, 2001; Lim, 1983), our study lends on end to the role of GDP growth on FDI in the selected countries Nigh (1985), however, reports a weak correlation between growth and FDI while Ancharaz (2003), using Sub-Saharan Africa as a study sample, reports the insignificant impact of the growth of GDP on FDI. In summary, the mixed bag of results from the existing studies support the statistically insignificant result of growth of GDP of our study.

However, FDI is positively related to domestic market size, which is measured by the size of GDP. The significant and positive relationship between FDI and domestic market size suggests that the major portion of the FDI in the selected 15 countries is driven by the market-seeking purpose of FDI. This is consistent with the previous empirical literature, which signifies that a larger local market indicates higher potential demand for FDI

Determinants	(1) Fixed effect cross	(2) Fixed effect cross and period (White cross-section; standard error and Covar corrected)	(3) GMM system (first difference, White-period; standard error and Covar corrected)	(4) Panel ARDL (Max lag 1 – automatic selection, AIC) Long-run estimates only
$LFDI_1$			−0.12[b] (−2.02)	
LGDP	1.6834[a] (16.59)	1.006[a] (4.15)	2.55[a] (6.75)	1.43[a] (22.1)
OPEN	0.8817[a] (4.85)	0.397[c] (1.84)	0.727[b] (2.38)	0.695[a] (5.339)
INF	−0.0553[a] (−6.31)	−0.048[a] (−5.08)	−0.014[c] (−1.83)	0.0079 (0.47)
POL	0.5977[a] (4.71)	0.549[a] (4.79)	0.575[a] (4.85)	0.727[a] (4.39)
GRO	0.0157 (1.16)	0.026 (1.56)	–[d]	–[d]
Dependent	LFDI	LFDI	LFDI	ΔLFDI
R-squared	0.91	0.85	–	–
N	188	188	157	162

Notes: Coefficients are presented with respect to their significance levels; [a] = Significant at 1%, [b]= significant at 5%, and [c]= significant at 10% levels; figures in parentheses () are the *t*-statistics; Model (3) J-statistics 8.98(p = 0.530), [d]= Growth of GDP (GRO) is avoided because of the inclusion of the first difference term in the model, Model (4) co-integrating vector coefficient −0.603 (p = 0.000), Model (4) Log Likelihood = 21.989, Except for LGDP, none of the variables from Model (4) is significant at the short-run; AIC = Akaike Information Criterion was used in Model (4); *N* = total unbalanced panel

Table IX. Results of panel regression

allowing the foreign investors to utilise the resources more efficiently (Ang, 2008; Jadhav, 2012; Hoang and Goujon, 2014). Further to this, these arguments are supported by Jordaan (2006), who has stated that the foreign investors will invest in larger countries with expanding markets that have greater purchasing power so that investors can potentially make a higher return on their investments.

Consistent with the expectation, political stability demonstrates a positive relationship with FDI. Despite the low political stability indicators of some countries observed in the descriptive statistics, current results provide evidence that the initial perception holds. The countries with better political governance attract more FDI investments. Goswami and Haider (2014), abridging 12 indicators of political risk to three factors - governance failure, cultural conflict and partners' attitude, have reported that the governance failure has a positive effect on the inflow of FDI while cultural conflict and partner's attitude dissuade FDI in their sample of 146 countries. Hence, this is an essential factor that will affect the investment decision in a particular country (Moosa, 2002).

Trade openness boosts FDI inflow. This is because multinational enterprises prefer to invest in markets that report less stringent trade barriers. It is believed that strict trade barriers increase the transaction costs. Additionally, the volume of trade in a country is important as most of the FDI is export oriented, which requires the import of complementary, intermediate, and capital goods. Thus, higher volume of trade suggests a higher exposure of trade (Sahoo, 2006). The study by Aw and Tang (2010) has reported a similar argument that trade liberalisation has a significant influence on the host country's economy as liberal policies help attract more FDIs.

Higher inflation rate reduces FDI inflow. Investors prefer a country with a stable macroeconomic condition since the benefit of investing would fall in the event of rising inflation rate (Asiedu, 2002). Yol and Teng (2009) have found that the low inflation rate in Malaysia has caused the economy to undergo a period of broad diversification experiencing sustainable rapid economic growth as well as achieving low unemployment rate that makes Malaysia an attractive destination for foreign investors.

First lag of the FDI negatively influences FDI (GMM estimates – Model 3). Only GDP exhibits a short-term relationship with FDI (Panel ARDL – Model 4). Our results exhibit the possibility of dynamic interactions of several factors with FDI. In Model 4, inflation rate does not report a significant long-term impact on the FDI. Except for the inflation rate, all other factors, GDP, openness, and political stability, have reported a significant long-term effect on FDI inflow.

5. Conclusion

In conclusion, the major determinants of FDI in the top 15 competitive countries in the Asia Pacific region are domestic market size, trade openness, inflation rate, and political stability. FDI inflow is related positively to domestic market size, trade openness, and political stability, and inversely related to the inflation rate. The empirical evidences of this paper are useful in making policies that can help to increase FDI inflows in order to promote economic development. Contrary to Jadhav (2012) and Kariuki (2015), our findings indicate that political stability is vitally important determinant of FDI inflows in the most competitive countries. Since foreign investors are more attracted to countries with high levels of GDP, which indicates a large consumer market size and a stable economy, countries must strengthen their economies so that the existing FDI can be secured and new foreign investors can be attracted. To enhance FDI flows, the policymakers should focus on building the image of the country, possibly the region, by ensuring stable economic and political

environment, maintaining macroeconomic stability, and the protection of property rights as well as the rule of law in order to create a safe environment for foreign investors.

Furthermore, policymakers can promote a more liberal trade policy in facilitating and attracting more FDI. For instance, policies that assist closer economic integration or cooperation should be encouraged. In addition, policymakers should place special emphasis on the following issues. Firstly it is important to determine the potential benefits of FDI linkages with the local economy. Thus, the government of every country should launch policies and devote resources to activities that will boost the FDI inflows, secondly the linkages between domestic and foreign firms should be encouraged. Vertical linkages between countries may be reduced by the barriers and restrictions on the flow of goods and services to a certain extent (Wei and Liu, 2006). Hence, the government revisit the existing international trade barriers within regions and promote regional economic integration instead.

Nevertheless, several limitations can be realized from this study. For instance, the omission of relevant variables as potential determinants and the inclusion of only 15 countries in the study as a small sample size cannot be used to generalise for all the countries. Therefore, for better estimation and justification, future researches can be improved further by taking into account a larger sample and applying other context dependent determinants of FDI.

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