CHAPTER I

INTRODUCTION

1.1 Research Background

One of the economic concepts that determine economic development is foreign direct investment. This economic development of the countries is seen in the context of market economy. Foreign direct investment is a mechanism that connects international economy. The trade impact of FDI relies on whether it is aimed for access to natural resources, consumer markets, or exploit strategic assets such as research and development sector. Developing countries are still lacking in technological capability and to increase that sector, FDI facilitates the technology transfer and reduce the technology gap between developing countries and developed countries. The most significant way to disseminate modern technology is by using FDI external effects. (Blomstrom & Wang, 1989)

FDI is illustrated as an investment from a resident entity in one country (foreign direct investor or home country) into an enterprise resident in another country (Foreign affiliate or host country) involving a long-term relationship and reflecting a lasting interest. It is including foreign investment that involved establishment of the new business and capital transfer (Folsom, Gordon, Spanogle, & Fitzgerald, 2005), foreign investors must be at least buy minimum of 10 percent of company shares or buy an existing overseas company or provide capital to build a new company in the host country.

FDI bring innumerous positive impact to economic performance in host country. Foreign direct investment provides the much needed foreign exchange to help bridge the balance of trade. It raises nation technology standards because of the technological transfer from the foreign country, opening new company in host country and uses local employees because cost effectiveness and provide quality output, foreign company trains the local human resources to boost their quality skill and productivity, FDI also beneficial in industries requiring the infusion of cutting-edge technologies from the home country (developed countries), eliminating local companies monopoly in process and beneficial impact to customers because now they can obtain quality products. Thus, we can establish that FDI is a main component for effective economic growth in developing countries, as the essence of economic development is the fast effective transfer and cross-border implementation of doing a better efficient way. (UNCTAD, 2006)

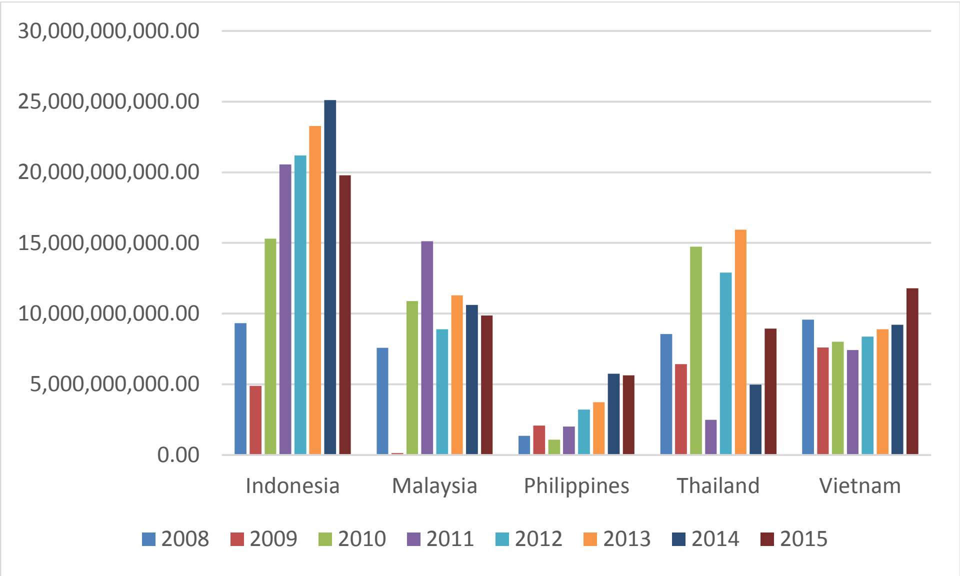
Flows of FDI consist of two mechanisms. First, capital is supplied (either directly or through associated business) by a foreign direct investor to FDI Company. Second, capital is obtained from an FDI Company by a foreign direct investor. In general, FDI comprise of three type: equity capital, reinvested earnings, and intra-company loans.

One of the key component of countries welfare is foreign direct investments. This leads to numerous studying of which factors that enhance or constrain an attractiveness of FDI into countries' economies. Most of the study use only economic factor or only use demographic factor of FDI inflows.

Exploring economic factors is essential because the obvious link between FDI and economic phenomena, although this should not lead to a reduction in the significance of other variables, but the mix between two of economic and demographic factor can bring a new answer on FDI determinants.

Only 22.46% of the variation of countries FDI can be explained by economic factor (Sparks, Desai, & Thirumurthy, 2014) even if there is a question about the significance of using the Country Liquidity Index as a proxy of economic factors, it seems to be accurate to state that economic determinants are not sufficient to explain the location of FDI. In the end there is no widely accepted explanatory variables that can be considered as a right determinants of FDI.

Graph 1.1 FDI in 5 developing ASEAN countries (2008-2015)

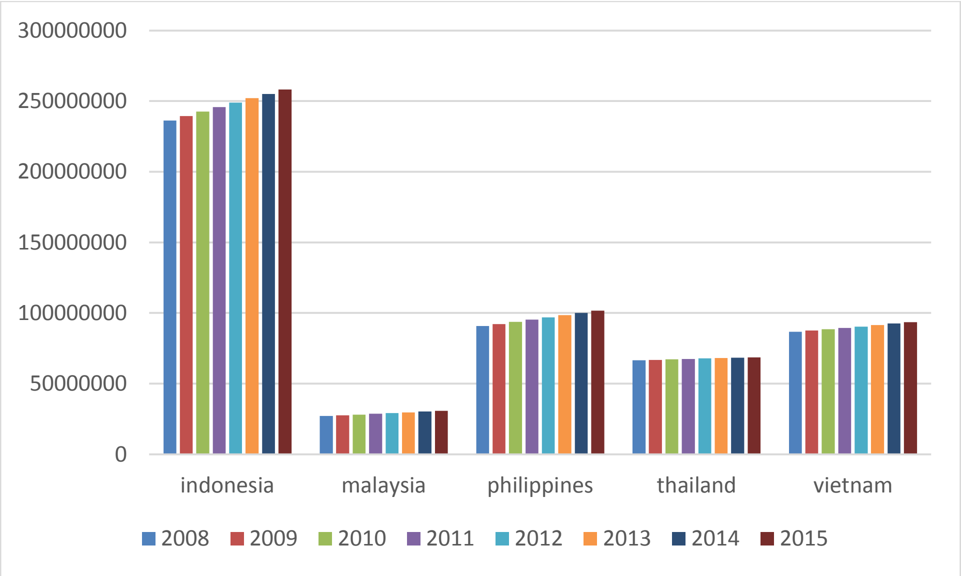


Foreign direct investment from 2008 until 2015 is shown at the graph below. As we can see, Vietnam have the highest FDI value in 2008, which is 9.57 billion US$, followed up by Indonesia with 9.31 billion US$ in foreign investment. Vietnam has a relatively large share of FDI in agriculture flows or stocks. The high share in Vietnam is due to influences such as the structure of domestic economy, availability of agricultural land (mostly for long term lease) and national policies (all of the policies that promoting investment in agriculture). FDI is focused a lot on certain cash crops such as sugarcane, cut flowers and vegetables. In developing area, the majority of inward FDI is focused on food and cash crops. (UNCTAD, 2009). Most countries globally experienced a fall in investment in 2009, because a lot of company were still dealing with the aftermath of the global credit crisis. Malaysia's FDI on a net basis fell horribly by 81% in 2009. ASEAN still remains as a major destination FDI destination, obtaining around 16% of the world FDI in developing economies 2015 with total FDI flows of $120 billion. In 2015, regional investment expansion by multinational enterprises (MNEs) was powerful and MNEs continue to enhance their production, finance, infrastructure, and other services. (UNCTAD, 2016)

Main source of FDI is still concentrated to developed countries, although in the last decades, destinations of FDI however changes with an increasing share going to developing countries. Precisely, the share of FDI to developing countries has increased from about 29 percent in 1970 to 47 percent in in 2011 (UNCTAD, 2013)

ASEAN countries has been part of this development. Some countries in the ASEAN region were the main option for multi-national enterprises to invest to, MNEs wanted to out-localize labor intensive part of the production. The countries continues to be a large FDI recipient with MNEs attracted by an increasing regional market, natural resources and as base for export oriented production. The characters and policies toward FDI vary between countries and over time within countries. Setting Indonesia as an example, Indonesia has commonly liberalized the FDI regime when the economy is doing poorly, and more regulations were introduced prices of raw material are rising and the economy is doing great. (Te Velde, 2001). In 2013, ASEAN accounts for roughly 8 percent of total world inflows of FDI which can be compared to around 2 percent of total GDP.

Graph 1.2 Total Population in 5 developing ASEAN countries (2008-2015)



In the graph 1.2 that based on the total population in ASEAN-5 countries on the total population in ASEAN-5 countries on 2008 until 2015, between these 5 countries, Indonesia had the largest total population and experiencing a stable population growth each year. In fact, Indonesia had 2.31 Billion total population in 2008, then 2.48 Billion total population on 2012, and 2.58 Billion total population in the end of 2015. Malaysia had a rather small population and population growth rather than Indonesia. Malaysia had 27 million total population in 2008, then 28 million total population on 2012, and 30 million total population in the end of 2015. Other than that, Philippines, Thailand, and Vietnam also had a stable population growth each year. Nowadays, Indonesia is the standing in rank 4 for largest total population country in the world. This is a big potential for investor to put their share in these developing countries.

The size of the market was broadly accepted as a significant determinant of FDI flows (Chakrabarti, 2001). Factors such as total population can have a significant impact to country business, hence affecting FDI in one country. Higher population have a positive impact on the steady state level of output. A simple reason for FDI is the search for new markets. The relationship between FDI and size of the host economy is positive. Size of the host economy often measured by its GDP or Population (Kobrin, 1976). Large population affect investors to be optimistically to think that large markets provide a reasonable capacity for investment and hence influence market-seeking FDI (Habib & Zurawicki, 2002). One of the reason china investment is doing very good lately is because of the large 1.2 billion population, thus created a promising enormous market and vast potential for consumption. This phenomenon create a rapid economic growth and continuously increased purchasing power for china and has made china attractive to market-oriented FDI, such as in the basic chemicals, drinks, household electrical appliances, automobiles, electronics, pharmaceutical industries. (OECD, 2000)

The main approach to measuring the health status of population and to evaluate health status improvement is using life expectancy (OECD, 2011). A large population bring an enormous investment into the country, but when the country health status is not convincing for the investor, as an investor this is seen as an investment unattractiveness. Foreign investors clearly observe their host country health standards, they recognize the excellence of good health and its positive impacts on potential workers, put more cash into the investment in countries with relatively good standards. Not only observing the health status, investor rarely want to invest in a country with a rampant disease and limited access to health care, afraid to endangered their own health and staff. This phenomenon encourages people to finds the truth scientifically. It is founds that life expectancy support and have a positive impact to gross FDI inflows (Alsan, Bloom, & Canning, 2006). These findings are consistent with the view that health is an integral component of human capital for developing countries.

In addition to total population, other demographic variable that is used to determine foreign direct investment is rate of population density. Rate of Population density portray distribution of population in region. The level of population density is result from a comparison of total population with area of a region. Population density is not promoting FDI (Akin, 2009). On one hand high population density can bring and stimulate technological change, decrease transportation cost, increase efficiency. On the other hand, it may result in diminishing return to land and increasing the cost of either building or land, road and transportation congestion, hence the higher the population density lead to higher cost for the company.

GDP growth rate is also included in this research study, even though demographic factors is the main focus in the study, GDP growth rate should be still considered because of the vital factor for FDI and a lot of previous research founds that these 2 variables usually had positive relationship. The size of domestic market, as well the growth prospects of the recipient host economy are given high consideration when foreign investors relocate production into the host country (Bhasin & Manocha, 2016).

1.2 Research Problem

Increase in FDI is varies for each countries depends on how the factor that affecting FDI fluctuate each year. Demographic factor have their own impact on FDI whether it is makes FDI more attractive and increase the amount of FDI or vice versa. ASEAN is still dominated by developing countries and investor tend to invest their shares into developing countries because it is offer the potential of rewarding return. The purpose of this paper is to create a new insights for ASEAN countries which of the demographic factors that affecting FDI, thus creating a more explosive growth opportunities.

The focus on this study is to examine demographic factors of foreign direct investment in five developing ASEAN countries.

1.3 Objective of Research

1. To analyze the demographic factors of foreign direct investment in five developing ASEAN countries on 2008-2015

2. To explain the most impactful element of foreign direct investment in five developing ASEAN countries on 2008-2015

1.4 Significance of Research

1. This study expected to bring more insights for the writer that is related to demographic factors of foreign direct investment in five developing ASEAN Countries 2008-2015

2. This study hopefully also can bring new knowledge for the reader that is related to demographics factor of foreign direct investment in five developing ASEAN Countries 2008-2015