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Do Corruption and Peace Factors Affect the Inflow of Foreign Direct Investment? Malaysian Evidence

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ABSTRACT

Corruption has been the major enemy of a nation and economic development. Nowadays, investors have been very particular in investing their money, where qualities such as transparency, integrity, and good governance are considered when making their investment decisions. In addition, the elements such as national security and stability become parts of the influencing factors in the investment evaluation. Apparently, in recent decades, the world has been faced with these two threats not only politically but economically as well. Therefore, this study aims to examine the relationship and effect of corruption and peace factors on the inflow of foreign direct investment (FDI) in Malaysia from year 2011 to 2020. This study also investigates the association and impact of the two selected macroeconomic variables, namely the government expenditures and unemployment rate on the Malaysian FDI inflow. The times series annual data was analyzed based on the correlation and multiple regression tests (ordinary least square, OLS). The data was obtained from several sources such as the World Bank and Thomson Reuters DataStream. The OLS regression results show that corruption negatively influences the FDI while the peace factor has a positive impact on the FDI. As for the macroeconomic factors, government expenditures have a positive effect whilst the unemployment rate negatively impacts the FDI. These results are consistent with and in support of the previous studies. Overall, the four variables selected have explained the variation in the FDI by 87% and the variables fit in the model based on the p-value of less than 10%. Conclusively, the findings have significant implications specifically for the government or policymakers in combating corruption and enhancing national security and stability, to the investors and industry players in making investment and economic decisions besides adding to the existing literature on the relationship between corruption and peace factors with the FDI that is still much lacking in the Malaysian context.

Keywords:
FDI, corruption perception index; global peace index; macroeconomic variables; Malaysia.

1. Introduction

Foreign direct investment (FDI) has played an essential role in a nation's economic growth and development through increasing local capital formation and enhancing technical dissemination

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[1,2]. Specifically, for Malaysia which is a developing nation, FDI is considered as a pivotal mechanism to safeguard the country's economic performance and enhance the national well-being [3]. By attracting more FDI into the country, this will pave ways to the domestic industry players to contribute more to the country's gross domestic product (GDP) along with incorporating new knowledge, skills and processes into the domestic businesses. Besides, the FDI will help the foreign investors to establish or expand their businesses through subsidiary or acquisition control and transfer of resources [4].

In 2020, the COVID-19 pandemic posed a major threat to global trade and investment. Malaysia, as one of the economies that has been depending on international trade and FDI, was seriously affected by the trade and investment declines [5]. Malaysia had fallen behind the Philippines, Singapore, Indonesia, and Vietnam in terms of preferred ASEAN nations to invest in, with a 68 percent reduction in FDI projected for 2020 and this was a 37 percent more than the region's average decline of 31 percent [6]. From 2011 to 2022, Malaysia's net FDI inflows indicate a notable fluctuation trend, which range between USD 4.06 billion and USD 20.25 billion. Precisely, the net FDIs were steady at USD 15.12 billion in 2011, but then fell below USD 11.3 billion in the next four years before rebounding to USD 13.47 billion in 2016. Later, the net inflows dropped below USD 10 billion in 2017 and reached its lowest point at USD 4.06 billion in 2020, which was the worst in the decade due to the global health crisis, the COVID-19 pandemic. In 2021, the net inflows showed a strong recovery at USD 20.25 billion. However, the figure plunged below USD 15 billion in 2022 that could be attributable to the country's political scenario during the year. The following Table 1 summarizes the trend of Malaysia's net FDI inflows from 2011 to 2022.

Table 1
Net FDI inflows in Malaysia from 2011 to 2022

Year	Malaysia's Net Inflows of FDI (in USD billion)
2011	15.12
2012	8.90
2013	11.30
2014	10.62
2015	9.86
2016	13.47
2017	9.37
2018	8.3
2019	9.15
2020	4.06
2021	20.25
2022	14.73

(Source: The World Bank)

To date, corruption is not just an enemy to the government and society. Corruption has become the serious cancer that deforms the economy and deters the inflows of FDI into a country. The impacts of corruption on the economy are complex because it can contribute to skyrocketing transaction costs and delaying in projects performance. In addition, corruption creates uncertainty in the markets by pushing away the investors. Therefore, it is utmost importance to reveal the influence of corruption on the FDI inflows. In this study, the corruption will measured by the Corruption Perception Index (CPI). The CPI is the extent of corruption among people such as embezzlement, undue influence in the need's assessment, bribery of public officials involved in the award process, or fraud in bid evaluation, invoices, or contract obligations. According to Transparency International, Malaysia's CPI ranking had deteriorated six ladders from 51 in 2019 to

57 in 2020 out of 180 nations. The deterioration is concerning, as the index reveals a declining trend in the areas including public procurement, criminal logging, and leaders' unlawful land acquisition.

The peace factor also influences the investors' decision to invest in any country. Global peace is a chimerical scheme of terrestrial nonviolence in which nations enthusiastically engage voluntarily or through a form of governance that precludes national wars [7]. According to Das [8], the Global Peace Index (GPI) influences FDI inflow in right way. The GPI is determined to evaluate and quantify the economic advantages of peace. Malaysia is ranked 4th most peaceful country in Asia and 19th overall by the Institute for Economic and Peace (IEP), with a score of 1.525. Malaysia is ahead of many industrialized countries including Australia, Taiwan and South Korea. Despite a decline in FDI in 2020 due to the pandemic, the GPI of Malaysia remains intact.

Meantime, Malaysian government expenditures contribute around 25.37 percent of the country's GDP in 2020, up from 23.5 percent in 2019. The impact of COVID-19 had driven a rapid rise in government expenditures, where the government responded quickly by injecting a large amount of money to boost the economy and to get the economy back on track. However, during the global crises such as the financial crisis in 2007-2008 and the health crisis of COVID-19 in 2020-2021, the world's unemployment rate had risen sharply due to the businesses closure and inability of the firms to stay operate in the markets. The International Labour Organization (ILO) defines unemployment as the number of persons over the age of 18 who desire and are able to find work at a specific pay rate but are unable to be doing so [9]. According to the Department of Statistics Malaysia (DOSM), in 2020, Malaysia's unemployment rate increased to 4.5 percent, which was the highest level since 1993. Malaysia's labour demand slowed in 2020 as a result of the COVID-19 pandemic's effect.

Many previous studies investigated the relationship between FDI and the economic variables in Malaysia. For instance, Har *et al.*, [4] studied the influence of FDI on economic growth proxy by GDP and GNI as dependent variables whilst Ang [10] examined the impacts of real GDP, GDP growth, the levels of financial development, infrastructure development, trade openness and statutory corporate tax rate on the Malaysian FDI inflow. Whereas, Shahrudin *et al.*, [11] studied the causality and dynamic relationship between the Malaysian FDI with the economic variables, namely money supply and inflation rate whilst *Irpan et al.*, [12] studied the impact of FDI on unemployment rate in Malaysia along with the GDP and exchange rate as the explanatory variables. Nevertheless, there is scarcity in the number of studies that examine the impact of non-economic variables on the FDI inflow particularly on the Malaysian setting. Therefore, this current study aims to investigate the relationship and impacts of the non-economic variables, namely the corruption and peace factors combined with the economic variables, namely the government expenditures and unemployment rate on the FDI inflow in Malaysia.

2. Literature Review and Hypotheses Development

The FDI comes from the investors or firms, who are willing to invest their money based on the perceived gains that they are going to receive from the investment. Such behaviour is referred to 'loss aversion' that falls under the Prospect Theory, which suggests that investors emphasize more on perceived gains than perceived losses. The study by Clampit *et al.*, [13] note that the investor firms may engage in the escape-based FDI when the institutional environments become misaligned with their interests. Meanwhile, Wei [14] suggested the investor firms should be more vigilant when deciding to invest at the overseas markets that have complex external environment. Various risks have to be identified and considered before making investment decisions such as unbalanced economic development and increased environmental pollution. Another related theory is the Rational Expectations Theory, which states that investors will lend their money based on what they rationally expect to happen in the future. This theory is employed by Gu *et al.*, [15] who studied the impacts of the physical risk and transition risk on the FDI flows.

The study by Quazi [16] revealed that the coefficient of Corruption Perception Index (CPI) was statistically significant; implying that a higher CPI score shows lower corruption practice. Specifically, the study found a positive coefficient of CPI that indicates a higher CPI score increases FDI inflow. On contrary, empirical evidence by Zhorzholiani [17] shows a statistically significant negative relationship between FDI and the corruption in the case of Georgia, Armenia, and Azerbaijan. This result is in accordance with Budiono and Tulus [18], who concluded that corruption has inverse relationship with economic growth and development, particularly among the developing countries with poor political and economic administration. These two latter studies have used the CPI ranking instead of CPI score as the independent variable. The 1st (last) ranked country will have the highest (lowest) CPI score, thus drawing higher (lower) FDI inflow. Hence, the following hypothesis is established.

Hypothesis 1: The corruption negatively influences the FDI inflow.

The result by Hasan *et al.*, [7] demonstrated that the flow of FDI reduced the degree of international conflict and fostered cooperation among countries. In addition, enhanced international cooperation through reducing trade and money flow restrictions might contribute to a more peaceful world. This implies that international relations play an essential role in inculcating peacefulness that consequently drawing inflow of FDI into a country. A report by Institute for Economics and Peace Report [19] stated that the most peaceful countries received an equivalent to 2 per cent of their GDP in FDI inflow compared to 0.84 per cent received by the least peaceful countries. Therefore, the higher ranking in Global Peace Index (GPI), the higher possibility of FDI comes into a country and vice versa.

Hypothesis 2: The peacefulness positively influences the FDI inflow.

Using the panel data of four ASEAN countries, Hummaira *et al.*, [20] noted that government expenditure and FDI have joint positive significant effects on the economic growth. The results imply that the larger the governments spend particularly on the peoples' projects and development, the bigger impact on the economic growth. Likewise, the higher foreign investors put in their money in the countries, specifically the FDI, the more increases will be on the economic growth. The reasons are simple as these two factors will be the main catalysts in mobilizing other businesses or private sectors to get involved in and contribute to the economic growth. Meanwhile, studying on the five largest economies in ASEAN plus India and China, Othman *et al.*, [21] revealed that government expenditure had a long-term positive impact on FDI. Overall, the findings conclude that 1 percent rise in government expenditures, specifically on stabilizing the market and economy besides improving the infrastructure, result in 1.07 percent increase in FDI.

Hypothesis 3: The government expenditure positively influences the FDI inflow.

According to Shaari *et al.*, [22] increased FDI could assist Malaysia to reduce its unemployment rate. Furthermore, the study found that there is bidirectional causality between the real GDP and FDI. This shows that, on one hand, the level of economic growth potentially attracts more FDI into the country. On the other hand, the inflow of FDI will contribute to better economic growth of the country, thus reducing the unemployment. The study by Zeb *et al.*, [9] examined the impact of FDI on unemployment rate in Pakistan and concluded that FDI plays a significant role in unemployment reduction in the country. Apparently, as a result of increased FDI, more job opportunities are created, thus lowering the unemployment rate in the country. Meanwhile, *Irpan et al.*, [12] investigated the influence of FDI on Malaysia's unemployment rate. The study found FDI has a significant impact on Malaysia's unemployment rate. In Nigeria, the FDI has been found as one of the mechanisms to reduce the unemployment based on the negative coefficient despite the FDI insignificant result [23]. The study suggested that the government should come up with more effective policies and measures to increase employment that would entice foreign investors to the country in order to boost investment.

Hypothesis 4: The unemployment rate negatively influences the FDI inflow.

3. Data and Methodology

This study is a quantitative study that used annual time series data from 2011 to 2020. The independent variables consist of two non-economic factors (Corruption Perception Index and Global Peace Index) and two economic factors (government expenditure and unemployment rate). The dependent variable is the inflow of FDI into Malaysia. Hence, the main objective of this study is to examine the relationship and impact of the independent variables on the dependent variable. The secondary data were gathered from a variety of sources, including the World Bank, Knoema, Thomson Reuters DataStream, and Trading Economic. The following Table 1 summarizes the variables used in this study.

Table 2
Summary of Variables

Variables	Abbreviation	Definition and Measurement	Sources
Foreign direct investment inflow	FDI	The sum of capital comprises equity, long-term, and short-term capitals as reflected in the balance of payments (BOP).	The World Bank
Corruption perception index	CPI	A survey that assesses the perceived levels of corruption in the public sector in nations all over the globe. It is based on expert judgement; the CPI score ranges from 0 (very corrupt/lowest rank) to 100 (least corrupt/highest rank).	Thomson Reuters DataStream
Global peace index	GPI	The value of GPI ranges from zero (0) to one (1). A high result for this measure indicates a high level of peace and stability. Three major elements serve as the basis for the GPI assessment of global peace: the level of safety and security in society, the amount of internal and international conflict, and the degree of militarization.	Thomson Reuters DataStream
Government expenditure	GEX	The government's purchases of goods and services including public consumption, public investment, dividend payments, revenue transfers, and capital transfers.	Trading Economic
Unemployment rate	UNR	The unemployment happens when an individual who is actively looking for work is unable to find one. This rate is calculated as the ratio of number of unemployed people over the total number of people in the labour force.	Trading Economic

The data was analysed based the correlation matrix was used to check the correlation between the respective independent variable and dependent variable and between the independent variables. The orientation of the correlation between two variables is indicated by the sign of r, which ranges from +1 to -1. The closer the absolute value of r is to one, the greater the correlation between two variables. The two variables are perfectly positively correlated if the $r = +1$ whilst the two variables are perfectly negatively correlated if the $r = -1$. If the $r = 0$, the two variables are totally uncorrelated. The main technique of analysis is the regression analysis, which is a statistical method that attempts to investigate the relationship (positive or negative signs) between dependent and independent variables. Aside from estimating the relationship, the regression is also checking on the magnitude of impact (beta coefficients) and level of significance (p-value) of the independent variables on the dependent variable. The multiple linear regressions based on the ordinary least square (OLS) are employed in this study. The regression model that was tested in this study is given as follows:

$$FDI_t = \beta_0 + \beta_1 CPI_t + \beta_2 GPI_t + \beta_3 GEX_t + \beta_4 UNR_t + \epsilon_t \tag{1}$$

Where FDI inflow is the dependent variable at time t. β_0 is the constant represents the slope and β_1 to β_4 indicate the coefficients of each independent variable, measuring the changes in the dependent variable. CPI, GPI, GEX and UNR represent the independent variables at time t. ϵ is the error term or residual value. Besides the above tests, we also conducted the diagnostic test to check on the multi-collinearity problem based on the variance inflation factors (VIF) using the threshold of 10 or below [24]. All of the above tests were run using EViews software.

4. Results and Discussion

4.1 Correlation Analysis

Based on the results from Table 3, the government expenditure has a weak but positive correlation of 0.2517 with FDI. This could be interpreted that the government expenditure moves in tandem with the FDI inflow. In the meanwhile, the result shows that the unemployment rate has very high negative correlation of -0.8973 with FDI. The p-value less than 10 percent level of significance indicate the unemployment rate has a significant correlation with FDI, which means the FDI has strong inverse association with unemployment rate. Furthermore, the finding indicates that the global peace index is having moderate positive correlation with FDI of 0.4203. This result implies that the country's levels of safety, stability, conflict and militarization play important roles in attracting more FDI into the country. Likewise, the result could be interpreted that the more FDI coming into the country, the more peaceful and stable the country is. Despite its low correlation with the FDI of -0.3046, the corruption could have an influence on the FDI. The negative sign shows that the higher level of corruption in the country, the lower the FDI coming in and vice versa. This result suggests that the foreign investors take into consideration the level of transparency, integrity, governance and bureaucracy of a government before deciding to invest in any country. The correlation results also reveal that there is mild correlation, either positive or negative, between the independent variables as the coefficient values range between 0.2700 and 0.0600. These results indirectly imply that there is no serious multi-collinearity problem between the independent variables.

Table 3
Correlation Coefficients

Variable	FDI	CPI	GPI	GEX	UNR
FDI	1.0000	-	-	-	-
CPI	-0.3046	1.0000	-	-	-
GPI	0.4203	0.0579	1.0000	-	-
GEX	0.2517	-0.0654	0.1886	1.0000	-
UNR	-0.8973	0.1810	-0.2670	-0.2206	1.0000

4.2 Multi-collinearity Analysis

The multi-collinearity test was conducted as robustness based on the variance inflation factor (VIF), which measures how much the variance of the estimated regression coefficient is inflated when the independent variables are correlated. Based on the results in Table 4, the VIF values lie between 2.5 to 10, which indicate there is no serious multi-collinearity issue between the respective independent variables. In other words, there is no strong inter-dependence or influence between any two of the independent variables that could affect the regression estimation. Table 3 shows the VIF results.

Table 4
Variance Inflation Factors (VIF)

Variable	Centered VIF
C	NA
CPI	6.5289
GPI	2.4666
GEX	7.5593
UNR	10.6057

4.3 Multiple Regression Analysis

Based on the OLS results presented in Table 5, government expenditure and global peace showed positive relationship with FDI while unemployment rate and corruption perception showed negative relationship with FDI. Despite the insignificant *p*-value, the CPI shows the largest impact on the FDI inflow. This could be explained that the higher the corruption, the lower the FDI and vice versa. The peace factor also poses important influence on FDI, where the more peaceful, safe and stable the country is, the more foreign investors will invest in the country.

Next, the level of unemployment rate also gives impact on the FDI. The higher unemployment rate means the country's government has no effective and efficient policies to curb the unemployment issue. On contrary, the lower the unemployment rate shows the government has taken strong measures to eradicate the problem, thus creating the confidence among the foreign investors to invest in the country.

The government expenditure is no less important as it has positive impact on FDI. The more government spends such as to improve the economy, develop the infrastructure and stabilize the market, the more foreign investors are interested to invest in the country. The R^2 value is 0.8675 indicates that 86.75 percent of the variation in the dependent variable, FDI, is jointly explained by the variability of the four independent variables whilst the remaining 13.25 percent is explained by other factors that are not included in the study. Meanwhile, the *p*-value of F-statistic, which is less than 10 percent significance level, indicates that the four selected independent variables in the regression are strongly fit in the model and can be used to predict the FDI inflow.

Therefore, all the above results support our hypotheses. CPI has a negative but insignificant relationship with the FDI. This result partially supports Amarandei [25], who showed a negative but significant relationship between FDI and CPI in the case of Central and Eastern European states. The study by Kasasbeh *et al.*, [26] also found there is significant effect of corruption on FDI inflow in Jordan. Meanwhile, GPI that indicates a positive but insignificant relationship with FDI is consistent with Hasan *et al.*, [7] and the report by Institute for Economics and Peace Report [19], which suggested the more peace, safety and stability achieved by a country, the more FDI is coming into the country. The insignificant impact of government expenditure on FDI is consistent with Arawomo and Apanisile [27], who concluded that the government expenditure is unimportant factor in attracting FDI in the long run for the telecommunication sector in Nigeria. Meantime, the positive impact of government expenditure on the FDI is in support of Yadav *et al.*, [28] who presented the evidence from India.

Lastly, the unemployment rate that indicates a negative and insignificant relationship with the FDI is in accordance with Aktar *et al.*, [29] who found the FDI, is negatively related with unemployment rate in Turkey. The finding is also consistent with Mucuk and Demirsel [30] that proved unemployment rate is statistically insignificant with FDI because there is no causal relationship between the two.

Table 5
OLS Regressions Results

Variable	Coefficient	Prob.
C	6.0106	0.5501
CPI	-1.0332	0.7334
GPI	0.3134	0.5070
GEX	0.1539	0.9636
UNR	-0.2738	0.2456
R-squared	0.8675	
Prob. (F-statistic)	0.0669*	

**Significant at 10% CI*

5. Conclusions

In this study, we examined the relationship and influences of the CPI, GPI, government expenditure and unemployment rate on the FDI inflow of Malaysia from 2011 to 2020. In spite of the insignificant results, the coefficients of each independent variable support our hypotheses. The results disclosed by the correlation test are consistent with the OLS regression test. Apparently, the corruption practice plays the most crucial role in affecting the inflow of FDI out of the four factors. The foreign investors strongly take into account the level of accountability, integrity, transparency and good governance especially in the civil services and business activities when they decide to invest in the country. Therefore, it is utmost important for the government to contain the corruption problem by taking effective measures such as being transparent in reporting or publishing the information to the public, tightening the anti-corruption laws, enforcement and punishment, inculcating good behaviours and values among civil servants and business society, and encouraging the participation and engagement from the citizens and various stakeholders in the government decisions.

In addition, the level of peacefulness of the country also contributes to the FDI inflow. Foreign investors prefer to invest in a country that provides safety, security and stability in the community. Moreover, a country that has the least political conflicts either internally or internationally, and militarization action either directly or indirectly will be more favourable to the foreign investors.

Not to forget, the government expenditure also needs to be looked into because it has the potential to attract more FDI into the country. The government has to emphasize its spending on improving the most crucial areas such as education, healthcare, infrastructure, public security and welfare, and community development. The strategic and effective mechanisms also have to be taken by the government to boost the economic activities to eradicate the unemployment, which could be one of the deterrents for the inflow of FDI into the country.

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