

*The Comparison of Relationships between FDI per Capita and Democracy*

*in Indonesia and Malaysia*

外資與民主化的關係在印尼與馬來西亞的比較

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**Abstract**

Indonesia and Malaysia are the members of ASEAN and are neighboring countries. There are many similarities between Indonesia and Malaysia. First of all, Malaysia, Indonesia and Brunei are only three Islam-dominated countries in ASEAN. The major race in both countries is Malays and their official languages are Indonesian and Malaysian. However, Malaysian and Indonesian are almost the same language. Indonesia owns the most Chinese around the world except Chinese-dominated counties and Malaysia owns the highest Chinese population percentage around the world except Chinese-dominated counties. Both counties are seemed as developing countries. More and more developing countries are eager to receive FDI. As a result, developing countries need industrial, technology and innovation policies to help them in the building of these advantages to attract MNEs' investments (Mytelka & Barclay, 2004). Therefore, national policies and their institutions are the most critical factor concerning the investment decisions of MNEs (Zanatta & Queiroz, 2007).

**1. Introduction**

In Gerring's previous study (2005), the relationship between accumulative democratic level and GDP per capita is discussed. Previous study usually focuses on the relationship between contemporary level of democracy and growth. Instead of present level of democracy, Gerring thinks that democracy is best considered as an accumulated stock rather than level. The outcome is positive and significant. Therefore, the

researcher wonders whether the relationship between accumulative democratic level and foreign direct investment (FDI) holds.

Gerring argued that democracy plays an important role on economic performance via political capital if that democracy is remained over time. And political capital consists of political learning and political institutionalization. In addition, Gerring asserts polity type should be considered through a historical lens

which takes both democracy and time into account. In Gerring's study, the main independent variable is GDP per capita and dependent variable is accumulative democratic level. The correlation is positive and significant. Therefore, the researcher wonders what the relationship between accumulative democratic level and foreign direct investment (FDI) is.

The results are as follows. Democratic stock has a positive and significant relationship with FDI per capita while democratic level (2015) has no statistically significant effect on FDI per capita. It is consistent with Gerring's study. With respect to geographic differences, only East Europe, OECD and Latin America meet the standard and the relationship between democracy and FDI appears positive. However, in the areas of Africa, Asia, ASEAN, the relationship between democracy and FDI shows negative. In terms of regression of FDI if Malaysia and Indonesia, the correlation coefficient of Democracy of Indonesia is significantly negative. However, the correlation coefficient of Democracy of Indonesia is negative but not significant.

## 2. Research Questions

**Research Question 1:** What is the correlation between level of democracy one country possesses and foreign investment it attracts?

**Research Question 2:** What role do geographic differences play with respect to the correlation between level of democracy and foreign investment?

**Research Question 3:** What do different methods to measure democracy influence the correlation between level of democracy and foreign investment?

**Research Question 4:** What differences do relationships between FDI per capita and democracy in Indonesia and Malaysia show?

## 3. Data Collection

In Gerring's previous study (2005), the relationship between accumulative democratic level and GDP per capita is discussed. Previous study usually focuses on

contemporary level of democracy on the relationship between democracy and growth. Instead of present level of democracy, Gerring thinks that democracy is best considered as an accumulated stock rather than level.

The evolutionary process of the democracy influences present politics and enhances physical capital, human capital, social capital and political capital. In the outcome of Gerring's research (2005), the relationship of democracy stock with economic growth is positive and significant. In other words, the more democratic a country is, the more developed the economy of the country is.

## 4. Data Collection

In Gerring's study, the level of democracy of each country comes from Polity2 variable of the Polity IV data. The democracy stock as the independent variable of this study also is taken from this data base. This indicator is 21point scale (-10 to +10). In the Polity IV data, the levels of democracy of 155 countries are observed from the end of 19 century till 2016. Because the data of each country start from different years and the researcher tries to make the value of democracy stock to virtually represent the contemporary government and polity in the world, the researcher adds up the levels of democracy of each country from the end of Cold War (1991) to represent the accumulative democracy stock of each country. The end of Cold War is a milestone in contemporary world history and many new countries are established and existing countries determine and stabilize their polity since then. Compared with the democracy levels before the end of Cold War, the democracy levels can virtually represent the present political circumstances of each country and are referred to by multinational enterprises (MNEs) when they estimate investments in foreign countries.

In respect of the dependent variable, FDI per capita in 2019 of each country comes from the World Bank. In case other factors that are correlated with democracy

may account for FDI performance, the Corruption Perceptions Index (CPI) in 2018 from Transparency International, Doing Business Index (DBI) in 2018 from the World Bank, and GDP PPP per capita in 2018 from the World Bank are considered.

In research question 4, owing to limit of date, control variables are GDP per capita instead of GDP PPP per capita and economic grow rate (1970-2019) both from the World Bank. In addition, data of FDI are adopted as the dependent variable rather than FDI per capita and data of Democracy are collected as dependent variable instead of Democracy stock.

## 5. Results

The author applies Stata14 to perform statistical analysis. The descriptive statistics of each variable are presented in Table 1.

Table 1 Descriptive Statistics of Variables<sup>(1)</sup>

| Variable <sup>(2)</sup>                | Mean <sup>(3)</sup>      | (S.D.) <sup>(4)</sup>    | Min. <sup>(5)</sup>       | Max. <sup>(6)</sup>      |
|----------------------------------------|--------------------------|--------------------------|---------------------------|--------------------------|
| FDIpc <sup>(7)</sup>                   | 80407.21 <sup>(8)</sup>  | 422060.8 <sup>(9)</sup>  | -334930.7 <sup>(10)</sup> | 4725337 <sup>(11)</sup>  |
| Democracy Stock(1992-) <sup>(12)</sup> | .91.27 <sup>(13)</sup>   | 145.76 <sup>(14)</sup>   | -250 <sup>(15)</sup>      | 250 <sup>(16)</sup>      |
| Democracy2015 <sup>(17)</sup>          | 4.61 <sup>(18)</sup>     | 5.87 <sup>(19)</sup>     | -10 <sup>(20)</sup>       | 10 <sup>(21)</sup>       |
| Democracy-5 <sup>(22)</sup>            | 64.82 <sup>(23)</sup>    | 114.37 <sup>(24)</sup>   | -190 <sup>(25)</sup>      | 192 <sup>(26)</sup>      |
| Dichstock <sup>(27)</sup>              | 15.37 <sup>(28)</sup>    | 10.78 <sup>(29)</sup>    | 0 <sup>(30)</sup>         | 25 <sup>(31)</sup>       |
| Dichstock2015 <sup>(32)</sup>          | .68 <sup>(33)</sup>      | .47 <sup>(34)</sup>      | 0 <sup>(35)</sup>         | 1 <sup>(36)</sup>        |
| CPI <sup>(37)</sup>                    | 43.26 <sup>(38)</sup>    | 19.66 <sup>(39)</sup>    | 11 <sup>(40)</sup>        | 91 <sup>(41)</sup>       |
| DBIs <sup>(42)</sup>                   | 61.17 <sup>(43)</sup>    | 13.15 <sup>(44)</sup>    | 34.32 <sup>(45)</sup>     | 86.42 <sup>(46)</sup>    |
| GDP pc <sup>(47)</sup>                 | 12741.54 <sup>(48)</sup> | 18228.14 <sup>(49)</sup> | 318.94 <sup>(50)</sup>    | 103157.1 <sup>(51)</sup> |
| Area <sup>(52)</sup>                   |                          |                          |                           |                          |
| EASTEU <sup>(53)</sup>                 | .10 <sup>(54)</sup>      | .30 <sup>(55)</sup>      | 0 <sup>(56)</sup>         | 1 <sup>(57)</sup>        |
| AFICA <sup>(58)</sup>                  | .30 <sup>(59)</sup>      | .46 <sup>(60)</sup>      | 0 <sup>(61)</sup>         | 1 <sup>(62)</sup>        |
| LATIN <sup>(63)</sup>                  | .12 <sup>(64)</sup>      | .33 <sup>(65)</sup>      | 0 <sup>(66)</sup>         | 1 <sup>(67)</sup>        |
| OECD <sup>(68)</sup>                   | .22 <sup>(69)</sup>      | .42 <sup>(70)</sup>      | 0 <sup>(71)</sup>         | 1 <sup>(72)</sup>        |
| SEAN <sup>(73)</sup>                   | .06 <sup>(74)</sup>      | .23 <sup>(75)</sup>      | 0 <sup>(76)</sup>         | 1 <sup>(77)</sup>        |
| N <sup>(78)</sup>                      |                          | 155 <sup>(79)</sup>      |                           |                          |

### Research Question 1: What is the correlation between level of democracy one country possesses and foreign investment it attracts?

The relationship between the dependent variable (FDI per capita) and each independent variable (Democracy Stock, Democracy in 2015, Corruption Perceptions Index, Doing Business Index and GDP per capita) is showed in Table 2, Model 1 and Model 2 show that democracy stock has a positive and significant relationship with FDI per capita while

democracy level (2015) has no statistically significant effect on FDI per capita. It is consistent with the result of Gerring's study. It is reasonable to assume that the growth stems from regime history and current status. Democracy is best considered as an accumulated stock rather than level. Democratic regime fosters physical, human, social and political capital. However, if we consider other potential factors which might affect the coefficient, the coefficient between democracy stock and FDI is still positive but not significant in Model 3 and Model 4. It means that many factors intertwined with each other to influence one country's FDI. Recent works have acknowledged that public governance is an important determinant of FDI. Kaufmann (2004) defines public governance as six dimensions which are voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption.

Table 2 Correlation of FDI per capita, Democracy Stock, Democracy in 2015, Corruption Perceptions Index, Doing Business Index and GDP per capita<sup>(1)</sup>

|                                |                                 | (1) <sup>(2)</sup>   | (2) <sup>(3)</sup>   | (3) <sup>(4)</sup>   | (4) <sup>(5)</sup>    |
|--------------------------------|---------------------------------|----------------------|----------------------|----------------------|-----------------------|
| Democracy Stock <sup>(6)</sup> | Pearson <sup>(7)</sup>          | .127* <sup>(8)</sup> |                      | -.041 <sup>(9)</sup> | .077 <sup>(10)</sup>  |
| (1992-) <sup>(11)</sup>        | Sig. (2-tailed) <sup>(12)</sup> | .026 <sup>(13)</sup> |                      | .472 <sup>(14)</sup> | .177 <sup>(15)</sup>  |
|                                | N <sup>(16)</sup>               | 155 <sup>(17)</sup>  |                      | 155 <sup>(18)</sup>  | 155 <sup>(19)</sup>   |
| Democracy2015 <sup>(20)</sup>  | Pearson <sup>(21)</sup>         |                      | .098 <sup>(22)</sup> |                      |                       |
|                                | Sig. (2-tailed) <sup>(23)</sup> |                      | .084 <sup>(24)</sup> |                      |                       |
|                                | N <sup>(25)</sup>               |                      | 155 <sup>(26)</sup>  |                      |                       |
| CPI <sup>(27)</sup>            | Pearson <sup>(28)</sup>         |                      |                      |                      | -.162 <sup>(29)</sup> |
|                                | Sig. (2-tailed) <sup>(30)</sup> |                      |                      |                      | .004 <sup>(31)</sup>  |
|                                | N <sup>(32)</sup>               |                      |                      |                      | 155 <sup>(33)</sup>   |
| DBIs <sup>(34)</sup>           | Pearson <sup>(35)</sup>         |                      |                      |                      | -.106 <sup>(36)</sup> |
|                                | Sig. (2-tailed) <sup>(37)</sup> |                      |                      |                      | .063 <sup>(38)</sup>  |
|                                | N <sup>(39)</sup>               |                      |                      |                      | 155 <sup>(40)</sup>   |
| GDP pc <sup>(41)</sup>         | Pearson <sup>(42)</sup>         |                      |                      | .488 <sup>(43)</sup> | .482 <sup>(44)</sup>  |
|                                | Sig. (2-tailed) <sup>(45)</sup> |                      |                      | .000 <sup>(46)</sup> | .000 <sup>(47)</sup>  |
|                                | N <sup>(48)</sup>               |                      |                      | 155 <sup>(49)</sup>  | 155 <sup>(50)</sup>   |

\*. Significant at the p<0.05 level (2-tailed)<sup>(51)</sup>

\*\*. Significant at the p<0.01 level (2-tailed)<sup>(52)</sup>

### Research Question 2: What role do geographic differences play with respect to the correlation between level of democracy and foreign investment?

In Table 3, the author wants to understand whether the factor of geographic region plays an important role in the coefficient between democracy stock and FDI per capita. The 155 observed countries are classified as Africa, Asia, East Europe, Latin America, OECD (the

Organization for Economic Co-operation and Development), ASEAN (Association of Southeast Asian Nations) and non-OECD in Table 3.

In Gerring's study (2005), if the value of the Polity2 is above 4, the year will be marked as democracy. Therefore, in this research, we can define the country with 120 above in the accumulative value as a democratic country because we add up the values of Polity2 from 1992 to 2015. In Table 4, the means of democracy stocks in each classified area are displayed. Only East Europe, OECD and Latin America can be seemed as more democratic geographic area. On the other hand, Africa, Asia, ASEAN and non-OECD appear less democratic.

In Table 3, the relationship between democracy and FDI appears positive in East Europe, OECD and Latin America. However, in the areas of Africa, Asia, ASEAN, non-OECD, the relationship between democracy and FDI shows a negative sign.

This proves the view that democracy has either a negative effect on economic growth or no effect in less developed countries. The governance of the less developed countries tends to weak. The institutions of those countries are extremely manipulated and it was not fully transformed into well function institution (Desbordes & Julien Vauday, 2007). Therefore, corruption in those countries is more likely to occur (Luiz & Stewart, 2013). Firms possibly attempt influencing illegally in not well governed countries(Beets, 2005). Luiz and Stewart (2013), and Khanna and Palepu (2010) consider that corruption in developing countries causes uncertainty, less predictability in economic activities and additional costs on MNEs and they have to respond.

More and more believe that authoritarian countries are more efficient and beneficial than democratic countries. In Table 3, the relationship between democracy and FDI in Asia is negative and

significant. The strong economic growth of China and Vietnam is a good example. Compared to more developed countries or areas, relatively immature democracy in less developed countries compared to more developed countries may cause more negative effects on attracting FDI.

In contrast, more developed countries possess more mature democracy. In less developed countries, their institutions are less trustworthy, transparent and irregularity (North, 1984). On the contrary, institutions of more developed countries are more trustworthy, transparent and irregularity. Foreign firms in developed countries tend to resort to legal lobbying activities. (Beets, 2005). Therefore, more democratic more developed countries are, more benefit MNEs can obtain from abundant capital, the state of the art technology, strong power of Research & Development (R&D) and skillful management.

Table 3 Correlation of FDI per capita and Democracy Stock by areas<sup>(1)</sup>

|                                |                                | Africa <sup>(2)</sup> | Asia <sup>(2)</sup>    | East EU <sup>(2)</sup> | Latin America <sup>(2)</sup> | ASEAN <sup>(2)</sup> |
|--------------------------------|--------------------------------|-----------------------|------------------------|------------------------|------------------------------|----------------------|
| Democracy Stock <sup>(2)</sup> | Pearson <sup>(2)</sup>         | -.042 <sup>(2)</sup>  | -.482** <sup>(2)</sup> | .347 <sup>(2)</sup>    | .269 <sup>(2)</sup>          | -.141 <sup>(2)</sup> |
| (1992-) <sup>(2)</sup>         | Sig. (2-tailed) <sup>(2)</sup> | .687 <sup>(2)</sup>   | .000 <sup>(2)</sup>    | .060 <sup>(2)</sup>    | .102 <sup>(2)</sup>          | .578 <sup>(2)</sup>  |
|                                | N <sup>(2)</sup>               | 47 <sup>(2)</sup>     | 31 <sup>(2)</sup>      | 15 <sup>(2)</sup>      | 19 <sup>(2)</sup>            | 9 <sup>(2)</sup>     |

\*. Significant at the p<0.05 level (2-tailed)<sup>(2)</sup>

\*\*. Significant at the p<0.01 level (2-tailed)<sup>(2)</sup>

Table 3 Correlation of FDI per capita and Democracy Stock by areas (continue)<sup>(1)</sup>

|                                |                                | OECD <sup>(2)</sup> | Non-OECD <sup>(2)</sup> |
|--------------------------------|--------------------------------|---------------------|-------------------------|
| Democracy Stock <sup>(2)</sup> | Pearson <sup>(2)</sup>         | .146 <sup>(2)</sup> | -0.063 <sup>(2)</sup>   |
| (1992-) <sup>(2)</sup>         | Sig. (2-tailed) <sup>(2)</sup> | .235 <sup>(2)</sup> | 0.493 <sup>(2)</sup>    |
|                                | N <sup>(2)</sup>               | 34 <sup>(2)</sup>   | 121 <sup>(2)</sup>      |

\*. Significant at the p<0.05 level (2-tailed)<sup>(2)</sup>

\*\*. Significant at the p<0.01 level (2-tailed)<sup>(2)</sup>

Table 4 Means of Democracy Stocks by areas<sup>(1)</sup>

|                         |  | Africa | Asia   | East EU | Latin America | ASEAN <sup>(2)</sup> |
|-------------------------|--|--------|--------|---------|---------------|----------------------|
| Mean of Democracy Stock |  | 29.45  | -22.26 | 133.33  | 182.79        | 4 <sup>(2)</sup>     |
| (1992-) <sup>(2)</sup>  |  |        |        |         |               |                      |

Table 4 Means of Democracy Stocks by areas (continue)<sup>(1)</sup>

|                         |  | OECD   | Non-OECD <sup>(2)</sup> |
|-------------------------|--|--------|-------------------------|
| Mean of Democracy Stock |  | 233.65 | 51.26 <sup>(2)</sup>    |
| (1992-) <sup>(2)</sup>  |  |        |                         |

### Research Question 3: What do different methods to measure democracy influence related to the correlation between level of democracy and foreign investment?

In Table 5, democratic levels are accumulated from 1992 to 2010 in order to test the relationship between

democracy stock and FDI is not an instance of reverse causality. Model 1 in Table 5 shows the coefficient between democracy stock and FDI is still positive and significant. Therefore, the relationship between democracy stock and FDI is not an instance of reverse causality.

In Table 5, Models 2-3 demonstrate the results if we measure democratic level in two scales, democracy and non-democracy. The value of Polity 2 which is greater than 4 is marked democracy. On the other hand, the value of Polity 2 which is not more than 4 is marked non-democracy. Accordingly, the values of Polity 2 are transformed. If democracy level is marked as democracy, the value is 1. On the other hand, if democracy level is marked as non-democracy, the value is 0. Models 2-3 appear that the relations between democracy stock and FDI or democracy level in 2015 and FDI are positive but not significant. The result sheds the concept of democracy should be better to be considered as continuous rather than dichotomous.

Table 5 Correlation of FDI per capita and Democracy stock-5, Dich stock and Dich Democracy<sup>4</sup>

|                             | (1)                                       | (2)               | (3) <sup>4</sup>  |
|-----------------------------|-------------------------------------------|-------------------|-------------------|
| Democracy stock-5           | Pearson .180** <sup>4</sup>               |                   |                   |
|                             | Sig. (2-tailed) .025 <sup>4</sup>         |                   |                   |
|                             | N <sup>4</sup> 155 <sup>4</sup>           |                   |                   |
| Dich stock <sup>4</sup>     | Pearson <sup>4</sup> <sup>4</sup>         | .098 <sup>4</sup> |                   |
|                             | Sig. (2-tailed) <sup>4</sup> <sup>4</sup> | .227 <sup>4</sup> |                   |
|                             | N <sup>4</sup> <sup>4</sup>               | 155 <sup>4</sup>  |                   |
| Dich Democracy <sup>4</sup> | Pearson <sup>4</sup> <sup>4</sup>         |                   | .067 <sup>4</sup> |
|                             | Sig. (2-tailed) <sup>4</sup> <sup>4</sup> |                   | .405 <sup>4</sup> |
|                             | N <sup>4</sup> <sup>4</sup>               |                   | 155 <sup>4</sup>  |

\*. Significant at the p<0.05 level (2-tailed)<sup>4</sup>

\*\*. Significant at the p<0.01 level (2-tailed)<sup>4</sup>

In Table 6, the regression model is estimated. The p-value for F-test is less than 0.05, indicating that the model can effectively explain FDI pc. The model explains 28.3% (or 30.2%) of variation of the FDI pc. On average, each one unit increase in accumulative democracy can increase FDI pc by 219.29 points, controlling for the other variables in the model constant. However, it is not significant. On average, each one

unit increase in CPI can decrease FDI pc by 6310.67 points, controlling for the other variables in the model constant and it is significant. On average, each one unit increase in DBI can decrease FDI pc by 4424.57 points, controlling for the other variables in the model constant. However, it is not significant. On average, each one unit increase in GDP pc can decrease FDI pc by 18.43 points, controlling for the other variables in the model constant and it is significant. The estimated regression model is as follow.

$$FDI\ pc = 369212.6 + 219.29(Democracy) - 6310.68(CPI) - 4424.573(DBI) + 18.43(GDPpc)^{4}$$

Table 6 OLS Regression Analysis of FDI per Capita with Accumulated Democracy<sup>4</sup>

| VARIABLES <sup>4</sup>          | Regression Analysis <sup>4</sup> |
|---------------------------------|----------------------------------|
| 1. Democracy <sup>4</sup>       | 219.2942 <sup>4</sup>            |
|                                 | (231.0247) <sup>4</sup>          |
| 2. CPI <sup>4</sup>             | -6310.677** <sup>4</sup>         |
|                                 | (3136.672) <sup>4</sup>          |
| 3. DBI <sup>4</sup>             | -4424.573 <sup>4</sup>           |
|                                 | (3384.719) <sup>4</sup>          |
| 4. GDPpc <sup>4</sup>           | 18.43349** <sup>4</sup>          |
|                                 | (2.73733) <sup>4</sup>           |
| Observation <sup>4</sup>        | 155 <sup>4</sup>                 |
| R-squared <sup>4</sup>          | 0.3019 <sup>4</sup>              |
| Adjusted R-squared <sup>4</sup> | 0.2832 <sup>4</sup>              |
| F-statistic <sup>4</sup>        | 16.21** <sup>4</sup>             |

\*. Significant at the p<0.05 level (2-tailed)<sup>4</sup>

\*\*. Significant at the p<0.01 level (2-tailed)<sup>4</sup>

In Table 7, accumulated democracy is replaced with democracy level in 2015. The regression model is estimated. The p-value for F-test is less than 0.05, indicating that the model can effectively explain FDI pc. The model explains 28.5% (or 30.4%) of variation of the FDI pc. On average, each one unit increase in accumulative democracy can increase FDI pc by 6144.79 points, controlling for the other variables in the model constant. However, it is not significant. On average, each one unit increase in CPI can decrease FDI pc by 6458.2 points, controlling for the other variables in the model constant and it is significant. On average, each one unit increase in DBI can decrease FDI pc by 4367.07 points, controlling for the other variables in the model constant. However, it is not

significant. On average, each one unit increase in GDP pc can decrease FDI pc by 18.64 points, controlling for the other variables in the model constant and it is significant. The estimated regression model is as follow.

$$FDI_{pc} = 361120.9 + 6144.79 (Democracy2015) - 6458.20(CPI) - 4367.07 (DBI) + 18.64(GDP_{pc})$$

Table 7 OLS Regression Analysis of FDI per Capita with Democracy in 2015<sup>(\*)</sup>

| VARIABLES <sup>(*)</sup>            | Regression Analysis <sup>(*)</sup>                      |
|-------------------------------------|---------------------------------------------------------|
| 1. Democracy2015 <sup>(*)</sup>     | 6144.792 <sup>(*)</sup><br>(5491.752) <sup>(*)</sup>    |
| 2. CPI <sup>(*)</sup>               | - 6458.197* <sup>(*)</sup><br>(3138.966) <sup>(*)</sup> |
| 3. DBI <sup>(*)</sup>               | - 4367.071 <sup>(*)</sup><br>(3351.555) <sup>(*)</sup>  |
| 4. GDP <sub>pc</sub> <sup>(*)</sup> | 18.64272 ** <sup>(*)</sup><br>(2.753985) <sup>(*)</sup> |
| Observation <sup>(*)</sup>          | 155 <sup>(*)</sup>                                      |
| R-squared <sup>(*)</sup>            | 0.3035 <sup>(*)</sup>                                   |
| Adjusted R-squared <sup>(*)</sup>   | 0.2849 <sup>(*)</sup>                                   |
| F-statistic <sup>(*)</sup>          | 16.34** <sup>(*)</sup>                                  |

\*. Significant at the p<0.05 level (2-tailed)<sup>(\*)</sup>

\*\*. Significant at the p<0.01 level (2-tailed)<sup>(\*)</sup>

#### Research Question 4: What differences do relationships between FDI per capita and democracy in Indonesia and Malaysia show?

In Table 8, the regression model of Malaysia is estimated. The p-value for F-test is less than 0.05, indicating that the model can effectively explain FDI. The model explains 84.5% (or 83.5%) of variation of the FDI . On average, each one unit increase in democracy can decrease FDI by 509000000 points, controlling for the other variables in the model constant. However, it is not significant. On average, each one unit increase in GDP pc can decrease FDI pc by 1176232 points, controlling for the other variables in the model constant and it is significant. On average, each one unit increase in economic grow rate can decrease FDI pc by 205000000 points, controlling for the other variables in the model constant and it is significant. The estimated regression model is as follow

$$FDI_{pc} = 509000000(Democracy) + 1176232(GDP_{pc}) + 205000000 (Economic Grow Rate) - 425000000$$

Table 8 OLS Regression Analysis of FDI with Democracy of Malaysia<sup>(\*)</sup>

| VARIABLES <sup>(*)</sup>              | Regression Analysis <sup>(*)</sup>                        |
|---------------------------------------|-----------------------------------------------------------|
| 1. Democracy <sup>(*)</sup>           | -5.087e+08 <sup>(*)</sup><br>(2.654e+08) <sup>(*)</sup>   |
| 2. GDP <sub>pc</sub> <sup>(*)</sup>   | 1.176e+06*** <sup>(*)</sup><br>(89,247) <sup>(*)</sup>    |
| 3. GDP <sub>Rate</sub> <sup>(*)</sup> | 2.052e+08*** <sup>(*)</sup><br>(6.816e+07) <sup>(*)</sup> |
| 4. Constant <sup>(*)</sup>            | -4.255e+08 <sup>(*)</sup><br>(1.025e+09) <sup>(*)</sup>   |
| Observation <sup>(*)</sup>            | 50 <sup>(*)</sup>                                         |
| R-squared <sup>(*)</sup>              | 0.846 <sup>(*)</sup>                                      |
| Adjusted R-squared <sup>(*)</sup>     | 0.836 <sup>(*)</sup>                                      |
| F-statistic <sup>(*)</sup>            | 83.96 <sup>(*)</sup>                                      |

\*. Significant at the p<0.05 level (2-tailed)<sup>(\*)</sup>

\*\*. Significant at the p<0.01 level (2-tailed)<sup>(\*)</sup>

\*\*\* Significant at the p<0.001 level (2-tailed)<sup>(\*)</sup>

In Table 9, the regression model of Indonesia is estimated. The p-value for F-test is less than 0.05, indicating that the model can effectively explain FDI. The model explains 87.7% (or 86.5%) of variation of the FDI . On average, each one unit increase in democracy can decrease FDI by 283000000 points, controlling for the other variables in the model constant and it is significant. On average, each one unit increase in GDP pc can decrease FDI by 7182738 points, controlling for the other variables in the model constant and it is significant. On average, each one unit increase in economic grow rate can decrease FDI by 81300000 points, controlling for the other variables in the model constant. However, it is not significant. The estimated regression model is as follow.

$$FDI_{pc} = -283000000 (Democracy) + 7182738 (GDP_{pc}) + 81300000 (Economic Grow Rate) - 502000000$$

Table 9 OLS Regression Analysis of FDI with Democracy in Malaysia<sup>(\*)</sup>

| VARIABLES <sup>(*)</sup>              | Regression Analysis <sup>(*)</sup>                         |
|---------------------------------------|------------------------------------------------------------|
| 1. Democracy <sup>(*)</sup>           | -2.830e+08** <sup>(*)</sup><br>(9.757e+07) <sup>(*)</sup>  |
| 2. GDP <sub>pc</sub> <sup>(*)</sup>   | 7.183e+06*** <sup>(*)</sup><br>(560,386) <sup>(*)</sup>    |
| 3. GDP <sub>Rate</sub> <sup>(*)</sup> | 8.128e+07 <sup>(*)</sup><br>(1.368e+08) <sup>(*)</sup>     |
| 4. Constant <sup>(*)</sup>            | -5.024e+09*** <sup>(*)</sup><br>(1.092e+09) <sup>(*)</sup> |
| Observation <sup>(*)</sup>            | 50 <sup>(*)</sup>                                          |
| R-squared <sup>(*)</sup>              | 0.874 <sup>(*)</sup>                                       |
| Adjusted R-squared <sup>(*)</sup>     | 0.866 <sup>(*)</sup>                                       |
| F-statistic <sup>(*)</sup>            | 106.1 <sup>(*)</sup>                                       |

\*. Significant at the p<0.05 level (2-tailed)<sup>(\*)</sup>

\*\*. Significant at the p<0.01 level (2-tailed)<sup>(\*)</sup>

\*\*\* Significant at the p<0.001 level (2-tailed)<sup>(\*)</sup>

In general, the relationship between democracy and FDI appears negative both in Indonesia and Malaysia. The results correspond to the results of Africa, Asia, ASEAN and non-OECD. This proves the view that democracy has either a negative effect on economic growth or no effect in less developed countries.

The governance of the less developed countries tends to weak. The institutions of those countries are extremely manipulated and it was not fully transformed into well function institution (Desbordes & Julien Vauday, 2007). Therefore, corruption in those countries is more likely to occur (Luiz & Stewart, 2013). Firms possibly attempt influencing illegally in not well governed countries(Beets, 2005). Firms possibly attempt influencing illegally in not well governed countries(Beets, 2005). Luiz and Stewart (2013), and Khanna and Palepu (2010) consider that corruption in developing countries causes uncertainty, less predictability in economic activities and additional costs on MNEs and they have to respond.

More and more believe that authoritarian countries are more efficient and beneficial than democratic countries. The strong economic growth of China and Vietnam is a good example. Compared to more developed countries or areas, relatively immature democracy in less developed countries compared to more developed countries may cause more negative effects on attracting FDI.

Moreover, the correlation coefficient of Democracy of Indonesia is significantly negative. However, the correlation coefficient of Democracy of Indonesia is negative but not significant. Malaysia is more developed than Indonesia as for economy. As the result, the feature of Malaysia is between developed countries and developing countries. The effects of democracy on FDI are not as distinct as Indonesia.

## 5. Conclusions

First, democracy stock has positive and significant relation with FDI per capita while democracy level (2015) has no statistically significant effect on FDI per capita. It is consistent with Gerring's study. It is reasonable to assume the growth stems from regime history and current status. Democracy is best considered as an accumulated stock rather than level. Democratic regime endures foster physical, human, social and political capital.

Second, the relationship between democracy and FDI appears positive in more democratic areas. However, in less democratic areas the relationship between democracy and FDI shows negative. It suggests democracy may play a positive role in attracting FDI in relatively democratic areas. However, democracy may have a negative effect on economic growth or no effect. More and more believe that authoritarian countries are more efficient and beneficial than democratic countries. The strong economic growth of China and Vietnam is a good example.

Third, the relationship between democracy stock and FDI is not an instance of reverse causality. The concept of democracy should be better to be considered as continuous rather than dichotomous.

Last but not least, In general, the relationship between democracy and FDI appears negative both in Indonesia and Malaysia. This proves the view that democracy has either a negative effect on economic growth or no effect in less developed countries. the correlation coefficient of Democracy of Indonesia is significantly negative. However, the correlation coefficient of Democracy of Indonesia is negative but not significant. The effects of democracy on FDI are not as distinct as Indonesia.

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