DOES CORRUPTION THREATEN FOREIGN INVESTMENT? : A CASE STUDY OF ASEAN-1

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Abstract

Foreign Direct Investment (FDI) is one of the important factors used by various countries to stimulate economic growth, as FDI provides capital for the host economy and promotes technology transfer. In addition to understanding the factors that encourage FDI inflows, identifying the factors that hinder FDI inflows in a country is equally important. Therefore, this study aims to empirically examine the role of corruption in the presence of FDI. Based on several previous studies, there are still differences in findings regarding how corruption affects FDI. Thus, this analysis specifically examines whether corruption harms or instead encourages the level of FDI in a country. This study uses secondary data from *Transparency International* (*Corruption Perceptions Index*) and the *World Bank*. The analysis period used in this study is from 2012 to 2024, applying a static panel method to determine the effect of corruption on FDI in 9 countries that are members of ASEAN. The results show that corruption has a significant effect on FDI, where the higher the Corruption Perceptions Index of a country, the higher the level of FDI.

Keywords: Corruption, Foreign Direct Investment, ASEAN, Panel

INTRODUCTION

Globalization has encouraged investors to choose to invest in places that offer attractive returns and relatively lower risks (Fernandez et al., 2020). Foreign direct investment (FDI) has become increasingly important in recent decades (Zander, 2021). Inflows of foreign direct investment (FDI) provide developing countries with access to capital that was previously unavailable, and FDI also provides much-needed foreign exchange, thereby helping to adjust several macroeconomic imbalances in developing countries (Fernandez et al., 2020). Shaari et al. (2022) also explain that FDI inflows, especially from developed countries, can help promote economic development in less developed countries. Many developing countries have replaced various restrictions on the entry of foreign multinational companies with new policies designed to attract and encourage FDI (Zander, 2021). The ASEAN Report 2024 states that the ASEAN Economic Community (*AEC*) Blueprint 2025 has played an important role in improving the investment policy environment throughout the ASEAN region. This has been carried out through (i) the implementation of regional agreements and frameworks aimed at enhancing economic integration and stimulating growth in strategic sectors, (ii) various national investment policy measures aimed at promoting and facilitating FDI, and (iii) agreements and partnerships with third countries. Investors and business associations acknowledge that AEC 2025 has made a significant contribution to improving the investment climate. FDI inflows, particularly to countries within ASEAN, have also continued to increase, especially since ASEAN was established in 1967 with the main objective of strengthening stability and economic growth.

Fernandez et al. (2020) explain that the emergence of globalization has made the mobility of money around the world very easy. Investors prefer to invest in places that offer attractive returns and relatively lower risks. Foreign direct investment (FDI) can play a key role in increasing the host country's capacity to respond to opportunities offered by global economic integration. Asian countries have become very prominent in this regard because of broad investment opportunities, cheap labor, geographical advantages, lower risks, and higher returns. One crucial factor influencing foreign investors' decisions is the quality of governance (good governance), including the level of corruption in a country. High corruption creates cost uncertainty, prolongs bureaucratic processes, and increases business risks. Practices such as bribery, illegal levies, and abuse of authority can create a high cost economy that reduces a country's competitiveness as an investment destination. Alemu (2012) explains that there are two assumptions regarding the impact of corruption on investment efficiency. First, corruption can shift the allocation of resources from productive sectors to unproductive sectors, so that investment is made not based on its rate of return, but based on the entrepreneur's ability to pay bribes. Second, bribery, which is often a major part of every act of corruption, increases production costs, which ultimately results in higher output prices, reduced demand, and eventually a decline in the capital ratio. Wang et al. (2020) also explain that when corruption is low, especially in developing countries, environmental regulations can be implemented effectively; thus, FDI will generally comply with host country regulations. Conversely, if the level of corruption is more severe, low-quality and environmentally unfriendly FDI can enter through bribery practices, which further worsen environmental pollution, creating a vicious cycle between corruption and pollution caused by FDI.

The issue of the importance of FDI is not the only concern for a country's economy, but the issue of corruption also has an impact on the inflow of foreign investment into a country. Various corruption cases show that corruption remains an important factor affecting state systems and economic activities worldwide. Corruption is expected to reduce the effectiveness and productivity of anticipated investment projects (Qureshi et al., 2021). A country's growth can be hindered by corruption, thereby disrupting business activities, reducing investment, hindering the functional activities of institutions, and weakening the expected economic policies of the country (Nizam & Liaqat, 2022). In addition, the level of corruption in the host country can affect investors' decisions regarding foreign investment; thus, it can be said that corruption affects FDI, and FDI affects economic development (Qureshi et al., 2021). High levels of corruption damage efficiency in public services, are considered obstacles to business, complicate project implementation, and reduce investor interest (Shaari et al., 2022). Alemu (2012) explains that one of the most damaging risks that multinational companies must consider when entering emerging market economies is the threat of corruption, which undermines economic reforms and ultimately national economic stability. Fernandez et al. (2020) also explain that corruption distorts competition and investment and hinders free and fair trade, where corruption makes investors dealing with government officials, for example, to obtain licenses and local permits, less transparent and more expensive, especially for foreign investors. Some major corruption cases that occurred in ASEAN countries in the last five years include the misuse of government funds for a flood control project worth billions of pesos in the Philippines, the PT Timah corruption case in Indonesia, the Vạn Thịnh Phát case in Vietnam, which caused losses of around US$27 billion, and the Military Corruption & Aides case in Malaysia. *Transparency International* explains that corruption affects billions of people around the world, destroying lives, weakening human rights, and worsening various global crises. Corruption also hinders concrete action when it is most needed, delays important policies, allows impunity, and exacerbates inequality. Corruption and efforts to fight it exist in various forms and show different trends around the world. Regions from America to the Middle East and the Pacific have their own challenges in dealing with corruption, but each region also holds hope, with each country taking different paths in the struggle to realize integrity. The Corruption Perceptions Index (CPI) 2024 released by Transparency International revealed that governments throughout the Asia-Pacific region, in particular, still failed to fulfill their anti-corruption promises. After years of stagnation, the average score of the Asia-Pacific region in 2024 actually fell by one point to 44. This condition is becoming increasingly concerning considering the harmful effects of corruption on the enforcement of regulations and policies, leaving the most vulnerable groups with very little protection or access to justice.

Currently, corruption remains a major challenge for many countries, and several studies also consider the role of corruption in Foreign direct investment (FDI). There are diverse findings regarding the relationship between corruption and FDI. Shaari et al. (2022) conducted an analysis of the impact of corruption on FDI in ASEAN countries and their three trading partners, namely China, Japan, and South Korea, during the 1995–2020 period using the panel ARDL analysis tool, and the results showed that a reduction in corruption can have a positive impact on FDI inflows in the long term. The same result was also found by Le et al. (2023), where corruption control has a positive impact on attracting FDI, indicating that lower corruption protects foreign investors from bureaucratic costs and unnecessary procedures. Better corruption control also increases investor confidence, so FDI inflows are more likely to increase. The analysis conducted by Alemu (2012) also shows that the effect of corruption on Foreign direct investment (FDI) inflows from 1995 to 2009 in 16 Asian economies indicates that a 1 percent increase in the level of corruption triggers a decrease in FDI inflows by approximately 9.1 percentage points. The results of Alemu (2012) indicate that countries can increase FDI by reducing the level of corruption occurring in their countries. Different results were found by Onody et al. (2022), who analyzed whether corruption acts as an obstacle to FDI or as a driver of FDI in Brazil during the 2012–2016 period, and the results found that corruption acts as a driver of FDI. The same result was also found by Moustafa (2021), who analyzed the dynamic relationship between corruption perception and Foreign direct investment (FDI) in Egypt during the 1970–2019 period, and the results of the Johansen cointegration technique and multivariate vector error correction model showed a positive relationship between corruption perception and FDI, supporting the "grease the wheels" effect of corruption. Various previous studies have provided diverse empirical evidence regarding the correlation between corruption practices and Foreign direct investment (FDI) flows. In general, the literature shows a negative tendency where corruption hinders FDI inflows and reduces the level of operational efficiency of companies.

Based on the results of previous studies, the majority of empirical studies support that corruption in investment destination countries tends to hinder FDI inflows. This occurs because corruption erodes investor confidence in the stability of the market system and the integrity of political institutions. On the other hand, there is debate from several previous studies arguing that corruption can actually stimulate investment by simplifying transaction procedures in certain countries, thus creating a positive correlation between corruption practices and FDI flows. This fact triggers the urgency to further examine the actual mechanism of the effect of corruption on FDI dynamics. Based on this explanation, this article aims to analyze the impact of corruption on foreign investment that can affect the interest and realization of FDI in ASEAN countries. This analysis uses the static panel estimation method to determine how corruption affects FDI in ASEAN-1, namely Cambodia, the Philippines, Indonesia, Singapore, Laos, Thailand, Malaysia, Vietnam, and Myanmar. The countries that are members of the ASEAN organization certainly have the same goal, namely maintaining regional stability and accelerating development through, among other things, investment. However, the existence of corruption is feared to cause investment setbacks for countries that are members of ASEAN.

REVIEW OF LITERATURE

Foreign Direct Investment

Foreign direct investment (FDI) is viewed as a significant driver of economic growth and a potential ally in the fight against poverty and inequality, so developing countries focus on attracting this type of investment (Onody et al., 2022). In reality, Foreign direct investment (FDI) plays an important role in many recipient countries, especially countries that lack capital and technology (Nguyen, 2022). FDI inflows can provide many benefits for recipient countries, such as increased employment opportunities, access to advanced technology, improved infrastructure, economic expansion, increased competitiveness, skill development through training, potential export growth, and increased capital inflows; particularly benefiting developing countries with limited domestic resources and restricted access to global markets (Muyambiri, 2025). Alemu (2012) states that according to modernization theory, FDI provides capital for the host economy, promotes technology transfer, and modernizes management skills as well as corporate governance. Awan & Waqas (2023) also state that FDI is an important component of economic growth that can increase productivity, employment opportunities, and technological progress. Foreign direct investment (FDI) has become an important driver of economic growth because it can lead to more efficient resource utilization and increased productivity (Shaari et al., 2022). Emeka (2024), in the analysis, found that FDI has a positive impact on economic growth, especially in Nigeria, by encouraging capital formation and technology transfer. Factors such as institutional quality and governance effectiveness greatly influence FDI inflows into a country. Challenges such as infrastructure deficits and policy instability can hinder the full potential of FDI. Therefore, creating a favorable investment climate and implementing appropriate economic policies are very important for sustainable economic growth. The results of the analysis conducted by Nguyen (2022) found that the positive impact of FDI on economic growth becomes stronger when financial development performs better, as measured using the banking sector and stock market. Muyambiri (2025) states that FDI is not only beneficial for recipient countries, but FDI outflows can also benefit the home country by increasing exports through enhanced production capacity abroad, creating new markets for domestic products, facilitating the transfer of technology and expertise back to the home country, generating foreign exchange income from international operations, and potentially increasing the competitiveness of domestic firms due to exposure to global markets.

Corruption and Institutional Quality

Zander (2021) states that there are two main views regarding corruption. The first is the sand the wheels view, which states that corruption has a negative impact on economic variables of concern (for example economic growth or FDI flows). This means that corruption harms the economy and hinders positive long-term change. Meanwhile, the second view called grease the wheels states that under certain conditions, especially when bureaucracy is inefficient, corruption can become a “second-best” solution that helps improve conditions compared to when corruption is completely absent. Corruption has proven to be a significant barrier to economic and social development because it weakens the institutional foundation and thus hinders regional economic growth (Qureshi et al., 2021). Corruption hampers economic growth because it diverts important resources and capital to uneconomical projects, and since FDI is one of the direct sources of capital acquisition, the unequal distribution of resources in developing countries limits economic growth prospects, resulting in capital erosion and making it difficult for various economic sectors to obtain funds to carry out their activities (Nizam & Liaqat, 2022). Bahoo et al. (2020) define corruption as illegal activities (bribery, fraud, financial crimes, abuse, forgery, favoritism, nepotism, manipulation, etc.) carried out through the abuse of authority or power by public (government) or private (corporate) officials for personal gain and benefit, whether financial or otherwise. The definition of corruption explained by Bahoo et al. (2020) includes three important characteristics of corruption in the context of international business. First, the person or company engages in some form of illegal activity. Second, the person or company abuses power or authority by violating existing rules and regulations or acting beyond legal boundaries. The third characteristic is that the person or company uses the position of power to gain personal benefit (financial or otherwise) rather than benefiting the state or shareholders. This definition is intended to cover all forms of corruption, including bribery, fraud, financial crimes, abuse, forgery, favoritism, nepotism, manipulation, and misrepresentation by public or private officials, both domestically and internationally, in social, business, or governmental contexts. Qureshi et al. (2021) also explain that corruption can be described as the abuse of public power for private gain, and corruption affects social and economic life, especially in developing countries, where corruption becomes a serious concern because it affects the achievement of long-term growth and sustainable development.

The Relationship Between Corruption and Foreign Direct Investment

The analysis conducted by Zander (2021) states that the impact of corruption cannot yet be concluded with certainty, where the effect of corruption on the economy is divided into two different assumptions. The first assumption states that corruption can provide benefits to the economy, while the second assumption states that corruption can obstruct the wheels of government and cause suboptimal economic outcomes. Corruption also reduces or distorts the fundamental role of government in areas such as contract enforcement and property rights protection, and ultimately corruption can reduce economic freedom by creating insecurity and uncertainty in economic relations (Alemu, 2012). Fernandez et al. (2020) also state that when the level of corruption is quite high, no investment will occur in that country. Different from the analysis conducted by Zander (2021), it was found that corruption has different effects on investing countries and recipient countries, where corruption is positively correlated with FDI inflows in recipient countries and negatively correlated with FDI inflows in investing countries. Zander (2021) explains that corruption in recipient countries shows a positive correlation, which can be interpreted as the tendency of corruption in destination countries effectively allowing a reduction in foreign investor risk premiums because corruption can be used to influence bureaucracy and investor-related regulations in a favorable way, while the level of corruption in investing countries has a negative effect on FDI, indicating that corruption is associated with the risk of ad-hoc intervention by governments and bureaucratic institutions toward part or all multinational companies. Therefore, companies may seek to reduce overall investor risk, which may include reducing *R&D* expenditures, so that the company's ability to generate a minimum level of owner-specific advantage can be hindered, resulting in a decline in FDI. This indicates that corruption has a complex and country-specific impact, so destination countries and source countries need to adopt different policies related to corruption. Similar results regarding differences in the effect of corruption levels were also found by Hanousek et al. (2021), who used a sample of private companies during the 2001–2013 period from 13 European countries regarding the impact of corruption levels and corruption uncertainty on investment in multinational companies and domestic companies. The results of the analysis showed that corruption levels and corruption uncertainty did not affect the level of investment made by multinational companies. Meanwhile, domestic company investment was influenced only by corruption uncertainty, but corruption levels did not affect investment made by domestic companies. The results of the analysis conducted by Qureshi et al. (2021) also produced different effects of corruption, where the study analyzed the relationship between corruption, FDI, and economic growth in developing and developed countries during the 1996–2018 period and showed that in developing countries with poor institutional quality and high levels of corruption, corruption encourages investment and economic progress, whereas in developed countries, low corruption encourages investment and economic development. The results of the analysis conducted by Belloumi & Alshehry (2021), who researched the relationship between corruption and FDI in the Gulf Cooperation Council during the 2003–2016 period, also found that in the short term corruption does not cause changes in FDI, but in the long term corruption can cause changes in FDI.

Based on previous empirical studies, the majority of findings indicate that corruption tends to hinder Foreign direct investment (FDI) inflows because it increases uncertainty, weakens institutional quality, and raises transaction costs for foreign investors. High levels of corruption also reduce transparency, complicate licensing procedures, and create inefficiencies in the business environment, which ultimately decrease investor confidence in the host country. Although some studies support the grease the wheels hypothesis by arguing that corruption may facilitate investment under certain institutional conditions, this study adopts the dominant perspective that corruption generally creates negative effects on investment activities, particularly in developing countries. Therefore, this study assumes that corruption negatively affects the level of Foreign direct investment (FDI) in ASEAN countries.

RESEARCH METHOD

This study uses a quantitative method with panel data from 9 ASEAN member countries during the 2012–2024 period. The year 2012 was chosen as the starting point due to the availability of corruption data from *Transparency International*. All data used in this study were obtained from secondary sources collected from the *World Bank* and *Transparency International*. Based on data availability for analysis, this study only includes 9 out of 11 ASEAN member countries, namely Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam. The dependent variable used in this study is foreign investment or Foreign direct investment (FDI) (Lestari et al., 2022). The independent variable used in this study is the Corruption Perceptions Index (*CPI*), which serves as an indicator of the corruption variable, along with several control variables including GDP per capita (*GDPKPT*), inflation (*INF*), and population (*LPOP*).

The model specification used in this study refers to the research of Lestari et al. (2022), which uses FDI as the dependent variable, and the study of Spyromitros & Panagiotidis (2022), which uses *CPI* as the independent variable. Therefore, the econometric model used to analyze the effect of corruption on FDI is as follows:

$$FDI_{it} = \beta_0 + \beta_1 CPI_{it} + \beta_2 GDPKPT_{it} + \beta_3 INF_{it} + \beta_4 LPOP_{it} + \varepsilon_{it} \quad (1)$$

Based on Equation (1), *CPI* is expected to have a positive effect on FDI. The Corruption Perceptions Index (*CPI*) refers to the index used by countries to assess the level of corruption, where scores range from 0 to 100, with 0 indicating a high level of corruption and 100 indicating a low level of corruption. A higher Corruption Perceptions Index indicates that a country has better governance and fewer corruption cases because the government takes corruption issues seriously. The effect of GDP per capita is also expected to have a positive impact on FDI. Higher economic growth or a larger market size indicates rapid development with higher investment returns, which can encourage greater FDI inflows into the country. Inflation and population are also expected to have a positive effect on FDI.

Table 1.
Variables

Variable	**Abbreviation**	**Source**	**Unit**
Foreign direct investment	FDI	World Bank	% of GDP
Corruption Perceptions Index	CPI	Transparency International	Index
Inflation	INF	World Bank	Percent
Population	LPOP	World Bank	Logarithm

RESULTS AND DISCUSSION

Several tests must be conducted before estimating the regression model, one of which is identifying the presence of stationarity using the unit root test. A summary of the stationarity test results can be seen in Table 2. Based on the results of the unit root test, all variables used in this study are stationary at the level form.

Table 2.
Unit Root Test

Variable	P-value of Levin, Lin & Chu Test Statistic
	Level
FDI	0.0000***
CPI	0.0249**
GDPKPT	0.0000***
INF	0.0020***
LPOP	0.0000***

Note: (*), (**), (***) indicate significance at the 10%, 5%, and 1% levels, respectively.

The next step is selecting the best model by testing whether the most appropriate model is Pooled Least Square (PLS), Fixed Effect Model (FEM), or Random Effect Model (REM). Based on the test results shown in Table 3, the Chow test indicates a probability value of 0.0000, which is smaller than 0.05, indicating that the best model is FEM. Furthermore, the Hausman test shows a probability value of 0.0823, which is greater than 0.05, indicating that the best model is REM. Finally, testing was conducted by comparing the

PLS and REM models using the Lagrange Multiplier test, and the probability value of Breusch-Pagan was 0.0000, which is smaller than 0.05, so the best selected model is REM.

Table 3.
Best Model Selection

Test	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	Best Model
Chow	165.745529	8	0.0000	FEM
Hausman	8.265163	4	0.0823	REM
LM (*Breusch-Pagan*)	–	–	0.0000	REM

Based on the estimation results of the best model, namely the Random Effect Model (REM) in Table 4, corruption (*CPI*), *GDPKPT*, and *LPOP* have a significant effect on FDI.

Table 4.
Estimation Results

Variable	Coefficient
CPI	0.101578**
	(0.0467)
GDPKPT	0.143646***
	(0.0035)
INF	0.038
	(0.323)
LPOP	-3.15***
	(0.006)
C	56.978***
	(0.0056)
Adj R^2	0.138
Probability (*F-statistic*)	0.0003

Note: *** Significant at the 1% level, ** Significant at the 5% level, * Significant at the 10% level.

Based on Table 4, *CPI* has a significant positive effect on FDI, where *CPI* has a coefficient of 0.101 and is significant at the 5% level, indicating that a 1% increase in the Corruption Perceptions Index will increase FDI by 0.101%. An increase in the CPI score indicates that a country is becoming less corrupt, which will increase the level of foreign investment entering that country. This result is consistent with the studies of Alemu (2012), Shaari et al. (2022), and Lestari et al. (2022), which state that the freer a country is from corruption, the greater its ability to build trust among foreign investors and make the country a primary destination for Foreign direct investment (FDI). Alemu (2012) explains that policymakers must prioritize anti-corruption efforts as one of the main prerequisites for creating a conducive environment to attract Foreign direct investment (FDI) into their economies. The main implication of this finding is that eradicating deeply rooted corruption in many Asian economies is highly necessary, and this can be achieved by improving good governance and ensuring better economic institutions, including strengthening the effectiveness and predictability of the judiciary, enforceable contracts, and the rule of law, eliminating the root causes of corruption and rent-seeking practices, and developing an environment where fair and predictable rules become the basis of social and economic interactions. Shaari et al. (2022) also found that reducing corruption can increase FDI inflows in the long term, making it very important to improve institutional quality, transparency, the rule of law, and other anti-corruption practices to increase investment inflows because lower corruption can reduce business costs and lower uncertainty and risk. The analysis conducted by Bahoo et al. (2020) also suggests that countries should strengthen international laws related to corruption to minimize the negative effects of corruption on Foreign direct investment, trade, business, and companies.

The estimation results also found that GDP per capita is one of the main positive factors driving FDI inflows. This can be seen in Table 3, where when *GDPKPT* increases by 1 percent, FDI increases by 0.14%. This result is in line with the study of Alemu (2012), which states that impressive past growth can provide greater confidence for foreign capital investment because past policies are most useful in predicting the future in countries with stable governments. The research results of Nizam & Liaqat (2022) also show that the relationship between GDP and FDI is positive and significant, where there is a positive and significant correlation between (*GDPKPT*) and (FDI). This result indicates that if (*GDPKPT*) increases, then (FDI) will also increase, and vice versa.

Based on Table 4, it is also shown that population size has a significant effect on FDI, where a 1% increase in population will reduce FDI by 3.15%. This result is in line with the study of Dutta et al. (2017), which also found that population growth has a negative effect on FDI. Ko et al. (2025) explain that in the Neo-Malthusian framework theory, rapid population growth is associated with political instability, especially in developing countries, which generally show weaker institutions, limited fiscal capacity, and lower carrying capacity, coinciding with greater socio-political tensions and inequality. Demographic expansion is not always accompanied by a proportional increase in resource availability, technological capacity, or infrastructure development. As a result, demand for essential commodities such as agricultural land, freshwater, and energy has in many places exceeded sustainable supply. This indicates that whether population growth attracts FDI still cannot be conclusively determined. However, what is certain is that the political, economic, social, technological, environmental, and legal context of a country plays an important role in determining the relationship between FDI and population growth.

CONCLUSION

The empirical evidence in this study generally confirms that corruption remains a significant problem for FDI inflows, particularly in ASEAN member countries, namely Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam. Based on *CPI* data from *Transparency International*, which is used to assess the level of corruption, the Corruption Perceptions Index (CPI) score ranges from 0 to 100, where 0 indicates a high level of corruption and 100 indicates a low level of corruption. The results of this study prove that the higher the CPI, which means the lower the level of corruption, the higher the FDI inflows into the country. This indicates that this study supports the theory that corruption is viewed as sand the wheels, meaning that corruption harms the economy and hinders positive long-term change. Based on the results of this study, countries need to improve fundamental governance structures, strengthen the role of anti-corruption institutions, and encourage productive investment by simplifying administrative procedures, which often become opportunities for corruption due to overlapping administrative bureaucracy.

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