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## Analysis of the Determination of Factors Influencing Foreign Direct Investment in ASEAN for the Period 2019-2023

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### ABSTRACT

This study aims to analyze the determinants of Foreign Direct Investment in ASEAN during the 2019–2023 period, considering economic and institutional factors. The main issue raised is the fluctuation of FDI inflows in ASEAN countries which are not always in line with economic growth, political stability, and the quality of regulations of each country. To answer this problem, a quantitative approach is used with a panel data regression model. The independent variables explained include Gross Domestic Product, Labor Force Participation Rate, Wages, Political Stability, Regulatory Quality, Inflation, and Interest Rates. The results of the analysis show that GDP has a significant positive effect on Foreign Direct Investment, Wages show a significant negative effect on Foreign Direct Investment, Labor Force Participation Rate and Interest Rates show a positive sign but do not significantly influence Foreign Direct Investment. While inflation has a negative sign but does not significantly influence Foreign Direct Investment. The Stability and Regulatory Quality variables show a negative sign that is not significant on foreign direct investment. This study concludes that the combination of economic growth and institutional strengthening is the main key in attracting Foreign Direct Investment. Therefore, for ASEAN countries that want to increase the attractiveness of foreign investment, it is necessary to focus not only on economic growth, but also on institutional reforms that support a long-term investment climate.

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## 1. INTRODUCTION

A strong financial system, including capital markets and stock markets, plays a crucial role in driving economic development. The stock market serves as a long-term funding platform for productive projects and businesses that can create jobs, reduce poverty, and drive economic growth. Within the broader economic landscape, investment is the driving force of economic activity, and Foreign Direct Investment (FDI) is a strategic form of investment that has a significant impact, particularly for developing countries [1].

Previous research has shown a positive relationship between FDI and stock market development; that is, increased FDI can improve a country's capital market performance [2] . This is evident in Indonesia and other ASEAN countries, where foreign investment supports stable regional economic growth [3]. The ASEAN region is currently a global focus due to its rapid growth, coupled with advantages such as affordable labor, abundant natural resources, and supportive policies for foreign investors. These conditions make ASEAN a region with significant potential to become a global economic powerhouse in the near future.

According to data published by the World Bank, Foreign Direct Investment inflows into ASEAN countries increase annually, with varying rates for each country. This is shown in Figure 1.

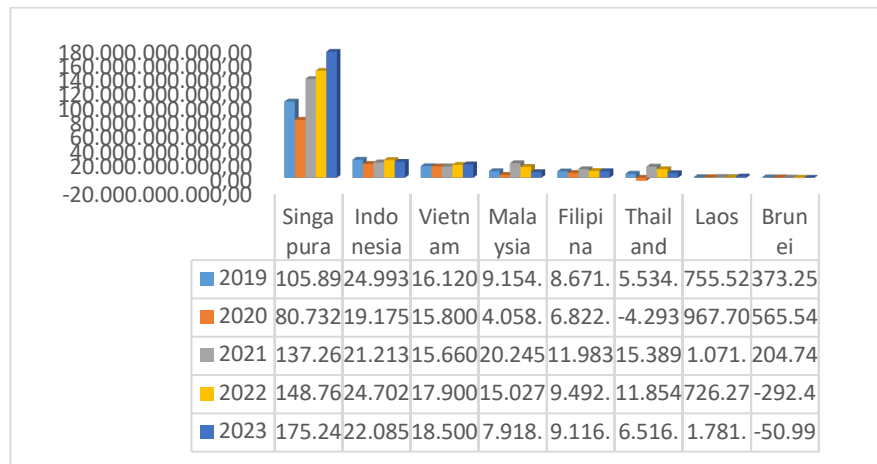


Figure 1. Foreign Direct Investment, 2019-2023

Based on the data above, each year from 2019 to 2023, Singapore consistently received the highest Foreign Direct Investment compared to other ASEAN countries. In 2023, Foreign Direct Investment inflows into Singapore reached 175,241 (Billion Dollars), a significant increase from the previous year. This demonstrates Singapore's strategic role as a financial center and investment hub in Southeast Asia. In Indonesia, it tended to be stable at around 19–25 billion dollars, indicating moderate Foreign Direct Investment growth, although it decreased slightly in 2023. Vietnam showed a significant upward trend from 16 billion (2019) to 18.5 billion (2023), indicating Vietnam is increasingly attractive to foreign investors, especially in the manufacturing and electronics sectors. Malaysia's FDI tends to fluctuate and decline (from 19 billion in 2019 to only 7.9 billion in 2023). FDI to the Philippines decreased drastically from 8.6 billion (2019) to 1.6 billion (2023). Thailand also showed a decline from 5.5 billion (2019) to 6.5 billion (2023), although it did increase in 2021. Laos showed significant fluctuations, even rising drastically to 2 billion in 2023 from 1 billion the previous year. Meanwhile, Brunei attracted attention because it showed a negative figure in 2023 (-50.992 billion dollars).

Foreign direct investment is heavily influenced by several key factors, one of which is economic growth, as reflected in Gross Domestic Product [4]. Foreign investment plays a crucial role in economic growth, increasing state revenues, public consumption, and investment in various industrial sectors [5].

According to World Bank data, Indonesia ranks highest in terms of GDP, with stable annual growth, indicating a strong and consistent economy. Other countries like Thailand, the Philippines, Malaysia, and Singapore have GDPs that are nearly comparable, while Vietnam is showing rapid growth and is approaching the economic achievements of major ASEAN countries. Meanwhile, Laos and Brunei are at the bottom, with slow or stagnant GDP growth.

A high GDP is an important indicator for foreign investors, as it indicates strong purchasing power and a profitable domestic market. Countries with rapidly growing GDPs are more attractive to investors for long-term investment, as they see greater business opportunities and profit potential there. Therefore,

the stronger a country's economic growth, the greater the likelihood of increased FDI inflows into that country, as demand for goods and services continues to grow, supporting business growth and investor profits.

ASEAN's large population creates a significant labor supply in the region, making it a major draw for foreign investment. However, labor force participation rates vary across countries, driven by both structural factors and external impacts such as the COVID-19 pandemic.

The number of salaried workers (wage/formal workers) is a key consideration for foreign investors before investing in a country. This is because investors are highly concerned with the availability of a qualified formal workforce and competitive wages to support their business operations and efficiency.

Labor conditions in ASEAN show that countries with strong formal sectors are more attractive to foreign investors because they offer a clear, organized, and productive workforce. However, competitive wages in most ASEAN countries are also a major draw. The combination of a large labor force, relatively low wages, and potential economic growth make ASEAN a favorable region for foreign direct investment.

While economic factors such as resource wealth and market growth are important in attracting foreign direct investment, the quality of domestic institutions also plays a crucial role. One of the main challenges facing developing countries in increasing FDI inflows is the weakness of domestic institutions.

A 2020 World Bank report further corroborates this by stating that political stability is the most important factor in investors' decisions to invest in a country, even more important than macroeconomic stability. This finding suggests that without legal certainty and a secure political environment, investors will tend to be reluctant to invest, even if the country has significant economic potential. Therefore, strengthening domestic institutions and creating a stable political environment are crucial steps that ASEAN countries need to take to increase their competitiveness in attracting FDI.

Inflation and interest rates are two important economic factors that indirectly influence foreign direct investment flows. Countries with low inflation rates tend to be more attractive to investors because they are perceived as more economically stable [6]. Besides the importance of inflation for foreign direct investment, interest rates can also influence foreign direct investment [7]. Interest rates are considered crucial in FDI because they are a consideration for investors or borrowers before deciding on a loan [8]. Essentially, an individual invests to gain profit, so the interest rate must be considered when making an investment. A planned investment will not be profitable for investors if the return on capital is lower than the interest rate [9].

Given the importance of these two indicators, researchers are interested in examining the factors influencing FDI in the ASEAN region in greater depth. This study combines economic factors such as Gross Domestic Product, labor force participation rate, wages, inflation, and interest rates, as well as institutional factors such as political stability and regulatory quality. The goal is to determine the extent and direction of each of these factors influence on FDI in ASEAN countries during the 2019–2023 period.

## **2. METHOD**

This study uses a quantitative approach with panel data that examines eight ASEAN countries: Brunei Darussalam, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam, during the period 2019–2023. Data collection is sourced from World Bank publications, specifically for the variables FDI, GDP, labor force participation rate, wage level, political stability index, regulatory quality index, inflation, and interest rates.

The dependent variable is FDI (foreign direct investment inflows, billion USD). The independent variables consist of:

- X1 : GDP (Gross Domestic Product, billion USD)
- X2 : Labor Force Participation Rate (%)
- X3 : Wage (percentage of salaried workers)
- X4 : Political Stability (-2,5 to 2,5)
- X5 : Regulatory Quality (-2,5 to 2,5)
- X6 : Inflation (%)
- X7 : Interest (%)

The analysis model used was panel data regression with the Fixed Effect Model (FEM) method, selected based on the results of the Chow and Hausman tests. The test was conducted to examine the partial and simultaneous effects of each independent variable on Foreign Direct Investment.

### 3. RESULTS AND DISCUSSION

Table 1. Partial Regression Coefficient Test Results

| Variabel   | t-statistik | t-tabel   | Prob/2  | A    |
|------------|-------------|-----------|---------|------|
| LOG_GDP    | 2.536291    | 2,034515  | 0.0089  | 0.05 |
| LABOR      | 0.462514    | 2,034515  | 0.3238  | 0.05 |
| WAGE       | -4.352017   | -2,034515 | 0.0001  | 0.05 |
| POLITICAL  | -2.619134   | -2,034515 | 0.0074  | 0.05 |
| REGULATORY | -1.983285   | -2,034515 | 0.0292  | 0.05 |
| INFLASI    | -0.002167   | -2,034515 | 0.49915 | 0,05 |
| INTEREST   | 2.240091    | 2,034515  | 0.0171  | 0,05 |

#### 3.1 The Influence of Gross Domestic Product on Foreign Direct Investment

This study found that Gross Domestic Product (GDP) plays a crucial role in attracting foreign direct investment (FDI) in ASEAN countries during the 2019–2023 period. Statistically, an increase in GDP significantly drives FDI inflows. This means that every US\$1 billion increase in GDP will increase FDI inflows into the ASEAN region by US\$1,895,428, assuming other factors remain constant.

This finding aligns with the theory that the larger a country's market size and national income, the greater the demand for goods and services. This increases the company's profit prospects, thus increasing investor confidence. With high supply and demand in the eight ASEAN countries, investors tend to be more receptive to investment, leading to an increase in FDI in the region.

This research is also supported by other studies [9], and [10] which demonstrate a positive and significant effect of GDP on FDI. Strong economic growth, supported by stable macroeconomic policies and infrastructure development, is a major attraction for foreign investors in choosing investment destination countries.

#### 3.2 The influence of the Labor Force Participation Rate on Foreign Direct Investment

Although ASEAN has a relatively high labor force participation rate, around 66–67%, and a large working-age population, this study shows that these variables did not significantly influence foreign direct investment (FDI) flows in the 2019–2023 period. The statistical analysis shows that while the relationship between labor force participation and FDI is positive, the relationship is not strong enough to significantly influence foreign investment decisions.

This finding indicates that a large labor force is not necessarily a primary attraction for investors, especially if the workforce is not accompanied by improvements in quality, such as education and skills.

This aligns with several other studies that state that the labor force's contribution to the economy will be limited if it is not accompanied by innovation and productivity.

These results align with research conducted by [11], which states that investors tend to choose countries with stable economic growth and a workforce that is not only large but also competent. Therefore, it is important for ASEAN countries to not only rely on labor force numbers but also invest in improving the quality of human resources to maximize foreign investment.

### **3.3 The influence of Wage on Foreign Direct Investment**

Over the past two decades, the ASEAN region has been in the global spotlight due to its stable and promising economic growth. One reason this region is attractive to foreign investors is its relatively low labor costs. This study shows that wages have a negative and significant effect on Foreign Direct Investment (FDI) in ASEAN during the 2019–2023 period.

The analysis reveals that every 1% increase in wages can lead to a decrease in FDI of 99,759.20 per billion US\$, assuming all other factors remain constant. This means that the higher the wage level in an ASEAN country, the less likely foreign investors are to invest in that country. This finding aligns with classical economic theory, which states that wage increases will increase production costs, ultimately reducing a country's competitiveness as an investment destination. Conversely, countries with low labor costs tend to be more attractive to investors because they can reduce production costs and increase profit margins. In the ASEAN context, maintaining a balance between labor welfare and production cost competitiveness is key to maintaining stable and sustainable FDI flows.

### **3.4 The influence of Political Stability on Foreign Direct Investment**

This study shows that political stability in ASEAN countries during the 2019–2023 period actually had a negative and significant relationship with foreign direct investment (FDI) inflows. This finding contradicts the common assumption that political stability should increase FDI. Empirical evidence shows that several countries with low political stability, such as Indonesia, Vietnam, and the Philippines, still managed to attract large amounts of FDI compared to countries like Malaysia, Laos, or Brunei, which have higher levels of stability.

This is primarily because countries with large populations and large domestic markets are considered more attractive to foreign investors, despite facing higher political risks. In other words, market potential and economic growth can offset the lack of political stability.

Furthermore, studies by [12] and [17] also found that political stability has a negative relationship with foreign direct investment. These studies found that excessive political stability can sometimes slow policy innovation and create rigid bureaucracy and regulations, which actually act as obstacles for investors. Global investors generally seek out countries with adaptive regulatory structures and significant market opportunities, making them willing to take the risk of political uncertainty in order to achieve greater returns.

In conclusion, while political stability is important, investors in ASEAN tend to prioritize market opportunities and potential economic growth over focusing solely on political security.

### **3.5 The influence of Regulatory Quality on Foreign Direct Investment**

This study found that regulatory quality had no significant effect on foreign direct investment (FDI) inflows into ASEAN countries during the 2019–2023 period. Although, in theory, good regulatory quality should support investor decisions, the analysis results actually show a negative and insignificant relationship. This means that better regulations in a country do not necessarily encourage foreign investors to invest.

This finding is inconsistent with Dunning's theory, which states that efficient institutions, including quality regulations, are a crucial factor in attracting FDI. However, this finding is supported

by several studies [13], which show that overly strict or formal regulations can hinder flexibility and ease of doing business, thus reducing investment attractiveness.

In practice, investors tend to seek ease in licensing and operational processes. If regulations are too complex or strict, this can increase business costs and risks, thus reducing investment interest. Therefore, while regulations are important, their flexible and business-friendly implementation is more crucial in attracting FDI.

### **3.6 The influence of Inflation on Foreign Direct Investment**

This study shows that inflation has a negative relationship with foreign direct investment (FDI) in ASEAN countries during the 2019–2023 period. However, the effect is not statistically significant. This means that while inflation has the potential to reduce investor interest, it was not a major factor influencing FDI in the ASEAN region during this period.

High inflation typically creates uncertainty in the business world because it increases production costs and prices, which can reduce profits and hinder investment decisions. However, in most ASEAN countries, inflation rates during 2019–2023 remained relatively low, below 10% per year, with the exception of Laos, which experienced high inflation of 31% in 2023. Stable inflation across most of the ASEAN region has encouraged investors to maintain their investment appetite.

This finding is also supported by several previous studies, including [10] and [14] which suggest that as long as inflation remains under control, foreign investors can still achieve greater profits than losses due to price increases. Therefore, even though inflation shows a negative direction towards FDI, the impact is still tolerable and is not a major obstacle in attracting foreign investment to the ASEAN region.

### **3.7 The influence of Interest on Foreign Direct Investment**

This study found that interest rates had a significant positive relationship with foreign direct investment in ASEAN during the 2019–2023 period. This means that rising interest rates are actually associated with increased FDI inflows into the region. This contrasts with classical economic theory, such as Keynes's, which assumes that rising interest rates should reduce investment interest by increasing the cost of capital. However, previous studies have found similar results to this study, including [10], [14], [15], and [16] where interest rates had no effect and had a positive effect on FDI. This positive finding can be explained by several factors specific to the ASEAN region, many ASEAN countries have strong economic growth and good macroeconomic stability. Foreign investment is more influenced by GDP growth and infrastructure than fluctuations in local interest rates. Investors view high interest rates in ASEAN not as a major obstacle, but rather as an indicator of economic stability that offers certainty and potential returns. In recent years, countries such as Indonesia, Vietnam, and the Philippines have remained top destinations for FDI despite fluctuating, sometimes even quite high, interest rates. Globally, following post-pandemic monetary easing, interest rate differentials within the region are no longer a key determinant of FDI, provided the macroeconomic environment is stable. Therefore, in ASEAN, rising interest rates often strengthen investor confidence in economic conditions, maintaining or even increasing foreign investment flows.

## **4. CONCLUSION**

This study aims to analyze the factors influencing Foreign Direct Investment in eight ASEAN countries (Brunei Darussalam, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam) during the 2019–2023 period. Partially, variables that have been shown to significantly influence Foreign Direct Investment include GDP (positive), wages (negative), political stability (negative), and interest rates (positive). Meanwhile, labor force participation, regulatory quality, and inflation have no significant effect on Foreign Direct Investment during the study period.

Simultaneously, the combination of all variables is able to explain 70.46% of the variation in Foreign Direct Investment in the ASEAN region.

This research opens the door for further development. Future studies could cover a longer time period to examine long-term patterns whether these influences are temporary or structural. Future research is also recommended to include micro-institutional variables such as bureaucratic efficiency, transparency, and ease of doing business, as macro-indicators like political stability and regulations alone have proven incapable of providing a complete picture of the influence of Foreign Direct Investment.

From an implementation perspective, the research findings can serve as a reference for the government in formulating conducive economic policies to encourage foreign investment. The government needs to maintain economic growth, improve workforce quality, establish competitive wage policies, and ensure political stability goes hand in hand with policy flexibility. Attention is also needed to organize regulatory implementation to be more effective in practice, not just on paper.

Overall, this research provides a strong basis for suggesting that Foreign Direct Investment investors consider economic prospects and cost efficiency more than formal institutional indicators alone. The findings of this study are highly relevant in supporting the formulation of more pro-investment policies and expanding the literature on Foreign Direct Investment dynamics in the ASEAN region.

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