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The Effect of Natural Resources Rent And Institutional Factors on Investment Inflow

Marselina[1*], Tri Joko PRASETYO[2]

[1]Faculty of Economics and Business, Universitas Lampung, Indonesia, email: marselinaunila@gmail.com
[2]Faculty of Economics and Business, Universitas Lampung, Indonesia, email: trijokoprasetyo@feb.unila.ac.id
E-mail: marselinaunila@gmail.com
*Corresponding Author

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Abstract

In addition to the rental price of natural resources and economic growth, institutional factors are one of the important factors influencing the interest of foreign investors in investing their capital in a country. According to the Heritage Organization, the important institutional factors are economic freedom and political stability. This study investigates the effect of economic freedom, political stability, natural resource rental rates and economic growth on the interest of investors to invest in a country. This study was conducted in 10 ASEAN countries during the period 2005-2019. The method used in this research is panel data regression. The results showed that through the Chow and Hausman tests, it was found that the Random Effect Model (REM) is the best choice of model to predict this investment inflow phenomenon. Furthermore, the variables of economic freedom and political stability as institutional factors, as well as economic growth in 9 ASEAN countries are able to attract foreign investors, and conversely, the relatively more expensive rental price for natural resources reduces the interest of foreign investors to invest their capital. For this reason, ASEAN member countries need to improve the structure of rental prices and the quality of natural resources as well as improve the quality of institutions, especially local institutions by reforming regulations to facilitate free and safe business operations and maintain political stability in their countries, through the implementation of consistent policies. which gives a sense of security to investing. Bureaucratic reform through simplification of regulations must be carried out so that business infrastructure is created efficiently.

Keywords: *Economic Freedom, Political Stability, Rental Price of Natural Resources, FDI*

Introduction

According to UNCTAD (1998), it ismentioned that the factors behind foreign investors entering a country are due to resource-seeking reasons. Recent literature showed that some countries with abundant resources are no longer attractive to investors(Asiedu, 2013; Poelhekke & van der Ploeg, 2012). The abundance of natural resources does not only have a positive impact on investment inflows, and even it tends to lead to economic disaster. However, other studies have found that FDI inflows persist in countries where natural resources are still concentrated in oil, diamonds, gas or gold. In addition, budget volatility, social conflict and environmental conflict pose a threat from mixed planning of the amount of income derived from the industrialization of natural resources(Sachs & Andrew M, 1995).

Institutional factors in a country play also an important role in attracting investors(Imtiaz, 2017). The required institutions are those that are able to support the market, are investment friendly, and can facilitate foreign investors by reducing unnecessary obstacles in their business operations(Wei, 2000). One of the supporting institutions is the economic freedom that is applied in a country. According toMarin & Schnitzer (2011) the government tries to attract investors through various policies that support improvements in institutional factors, including improvements in political and economic stability. The facilities provided by the state are in the form of an economic system that does not require much government intervention, a conducive climate can encourage the inflow of foreign capital for the country concerned(Kok & Ersoy, 2009). Dunning(1997) also stated that the advantages that a country must have to attract foreign investment are minimum trade barriers and the wide level of economic openness. One of the determinants of investment in developing countries is the quality of institutions, where the higher the quality of institutions, the higher the interest of investors to enter a country(Jude & Levieuge, 2017).

Foreign Direct Investment (FDI) as one of the main sources of long-term economic financing is the main financing option that many developing countries can use in facing an integrated global economy, because FDI is able to provide more stable growth than other forms of capital flows. The role of institutions in the entry of FDI into a country is still widely debatedAzman-Saini et al. (2010)stated that the lack of economic freedom as an institutional factor can limit the company's ability to absorb and internalize new technologies from multinational companies. Countries with a higher level of economic freedom will have a greater absorption capacity and make it possible to obtain more benefits from the entry of foreign investment. Policies that provide investment conveniences will attract investors to invest their capital, one of which can be reflected in economic freedom.Gwartney(2009)argued that the main constituents of economic freedom consist of individual protection of private property rights, freedom to compete, and voluntary exchange. With minimal government intervention, free and competitive markets provide greater opportunities for entrepreneurs to try new ideas (Duarte et al. (2017). Similarly,Zghidi et al.(2016)explained that economic freedom is an important element for economic progress. Economic freedom provides a better investment climate(Dkhili & Dhiab, 2018). The institutional climate of a country can be influential in encouraging or inhibiting the entry of foreign capital into a country. Policymakers should focus on improving the investment climate by raising its level through transparent policies, eliminating corruption, reducing the tax burden and a stable economy.(Habibi & Hidayat, 2017) found that the effect of economic freedom which includes trade freedom and tax freedom has a positive and significant influence on FDI inflows in ASEAN countries in the 2004-2015 period. In line with this,(Bengoa & Sanchez-Robles, 2003) found that the freedom of economists in 18 Latin American countries influences the entry of foreign investment. The level of economic freedom of each country can be measured using the index of economic freedom designed by The Heritage Foundation and Wall Street Journal which was first published in 1995. The measurement of economic freedom uses an index that provides indicators of prosperity and economic freedom in life, namely the creation of 10 components to measure the economic freedom of 185 countries around the world. Each component has a scale of 0-100 and the greater the index of economic freedom of a country, thefreer to operate.

In addition to economic freedom, another factor that can encourage the entry of investment into a country is political conditions(Ratna Fitri Anjani, 2017). The entry of foreign investors is strongly influenced by conditions of political stability as the unstable political climate couldhesitate foreign investors to invest in the country.Haksoon (2010) found that FDI inflows are strongly influenced by the level of political stability of the host country. Investors believe that political stability in the host country is a very important factor in choosing the investment location and the amount of investment to be invested. Political instability is considered a serious problem that harms economic performance(Samimi et al., 2011). Empirically found that political stability increases the likelihood of a country being chosen as an investment location(Woodward & Rolfe, 1993). When political stability in a country increases, foreign investors will be attracted to invest in that country. In line with the results of Woodward and Rolfe's research,Busse & Hefeker(2011)study showed that political stability, absence of internal conflict, and fulfilment of democratic rights are significant determinants of the entry of FDI.

Economic growth, according toSarwedi (2002), will affect the interest of foreign investors to enter. Economic growth can show a country's ability to produce goods and services. This is a favourable and positive situation for investors to invest in the country. The length of the market and the high purchasing power are the motivations for investors.

ASEAN is an attractive region for foreign investors. Based on the 2013 World Investment Report, there are four countries in ASEAN that attract the most investors, namely Vietnam, Indonesia, Thailand, and Malaysia. These four countries are included in 20 countries with top host economies for FDI from 2010 to 2012. Even based on a survey conducted by UNCTAD on transnational (TNC), during 2013-2015 ASEAN member countries were classified as a priority the destination country to be the host country FDI. The problem is how natural resource rental factors, economic growth andinsitutional factors affect the interest of foreign investors to enter countries in ASEAN.

Literature Review

According toIto & Krueger (2000), there are several factors that encourage the entry of investment in a country, namely a higher interest rate, the expected rate of return on investment, the level of national income, the benefits obtained by the company including a stable political situation, technological advances and conveniencefacilities provided by the government. According to the(UNCTAD, 1998)there are three reasons behind foreign investors to invest in a country, including:

Resource-Seeking is a type of investment made to obtain production factors in the form of natural resources or labour that are more efficient in other countries than in their own country.

Market-Seeking is a type of foreign investment aimed at finding new markets or maintaining old markets.

Efficiency-Seeking is an investment because it is motivated to create new competitiveness for the company and because of lower production costs including productivity considerations.

Economic Freedom

According to Heritage Foundation, economic freedom is the basic right of every human being to control his labour and property. In an economically free society, individuals are free to work, produce, consume, and invest as they please with freedoms protected and not restricted by the state. In an economically free society, the government allows labour, capital and goods to move freely, and refrains from coercion or restrictions on freedom beyond the limits necessary to protect and maintain that freedom itself. The Wealth of Nations states that "basic institutions that protect the freedom of individuals to pursue their economic goals will result in greater welfare for the wider society". According to Smith, a government that provides economic freedom to the people within the framework of free trade both in the domestic and international scope will be more prosperous. assessment of Economic freedom by Heritage Foundation rating based on 10 components, namely: Property rights, Government Integrity, Tax Burden, Government Spending, Business Freedom, Labour Freedom, Monetary Freedom, Trade Freedom, Investment Freedom, Financial Freedom.

Political Stability

Political stabilityis an important thing in economic politics. This can be understood as a condition where there are no fundamental changes in the political system (government), or changes that occur within predetermined boundaries(Plano, 1982). In addition, political stability describes the pattern and behaviour of all components of the political system that builds sustainable structures and power relations so as to ensure the effectiveness of government.

Political stability also describes the pattern and behaviour of all components of the political system that builds sustainable structures and power relations so as to ensure the effectiveness of government. Harold Crouch said that political stability is characterized by two things, first the existence of a stable government that consistently carries out its program in accordance with predetermined boundaries. Second, the government system is stable in the sense that the system is able to accept changes that occur in society without changing the existing government system.

Theoretically, political stability is determined by three interrelated variables, namely adequate economic development, institutional development both in structure and political process and political participation. Political institutions lead to the notion that there is no conflict between political forces. Unstable political dynamics can damage the investment climate because investors' fear will reduce the level of investor confidence in the level of investment security, so this can cause investors to move their capital to other countries that are considered better and safer for their business continuity. Political instability will lead to policy uncertainty or unclear law enforcement.

Theory of Economic Freedom

Adam Smith, through The Wealth of Nations stated that "basic institutions that protect individual freedom to pursue economic goals will result in greater welfare for the wider community". The spirit of Adam Smith's economic thought is an economy that runs without government intervention. Adam Smith's model is called Laissez Faire which comes from French. In general, this term is understood as an economic doctrine that does not want government intervention in the economy. Adam Smith viewed production and trade as the keys to unlocking prosperity. In order to maximize production and trade and generate universal wealth, Smith recommended that the government give economic freedom to the people within the framework of free trade both in the domestic and international scope.

Foreign Direct Investment(FDI)

Krugman & Obstfeld(2003) stated that Foreign Direct Investment (FDI) is an international flow of capital where companies from one country establish or expand their companies in other countries. Therefore, there is not only a transfer of resources, but also the enforcement of control over companies abroad. FDI includes not only the transfer of ownership from domestic to foreign ownership, but also a mechanism that allows foreign investors to learn about the management and control of domestic companies, particularly in the corporate governance mechanism. FDI means that companies from the investing country directly supervise the assets invested in the capital importing country and can take several forms, namely: the establishment of a branch company in the capital importing country; the formation of a company in the importing country which is solely financed by a company located in the country of the investor, establishing a corporation in the country of the investor to specifically operate in another country; or placing assets (fixed assets) in another country by the national company of the country of origin. investment country(Jhingan, 2012).

According to the Foreign Investment Theory, there are several reasons foreign investors wish to invest in a countryas follows:

The Organization Location and Internalization (OLI) Framework theory, proposed by John Dunning (1997, 1981, 1988) by combining three main theories ofFDI, which are industrial organization theory, internalization theory, and location theory. According to him, there are three conditions that must be owned by companies that want to make FDI: (1) Must have an ownership advantage over other parties or companies, (2) It is more profitable to take advantage of these advantages than selling or leasing to other companies, (3) It can be more profitable if it is combined with factors or inputs located abroad.

Theory Multinational Corporation.This theory was put forward by(Rugman, 1981), stating that there is an influence of environmental variables and internalization variables in making FDI. There are three types of environmental variables of concern, namely economic, non-economic and government. The economic variable in question is the overall production function of the nation. The factors in society are defined as labour, capital and in advanced models, technology variables, availability of natural resources and management skills are included. Non-economic variables in making foreign investment (FDI) are political, cultural and social variables in different nations. In fact, no country has identical economic and non-economic factors between countries. A company doing international business, will delve deeper into the culture, political system, and social values to minimize the additional cost of foreign investment in production in the country concerned. The internalization factor or company specific advantage (KSP) is another factor that influences foreign investment in a country. In essence, a multinational company is a monopolist as long as the company has a unique method of organizing its internal market.

David K. Eitemen's Theory. This theory suggests three motives that influence the flow of foreign investment to recipient countries, namely: strategic motives, behavioural motives, and economic motives. Strategic motives are distinguished in terms of looking for markets, raw materials, production efficiency, knowledge, and political security. Behavioural motives are external and other environmental stimuli and organizations based on individual or group needs and commitments. The economic motive is a motive for seeking profit by maximizing long-term profits and the company's stock market price.

Theory Rent-Seeking. The initial assumption of the concept of rent-seeking which was built from political economy theory is that each interest group (self-interest) seeks to obtain the maximum economic benefit with the least amount of effort. At this point, all available political economy resources, such as lobbying, will be used to achieve this goal. The problem is that if the product of the lobby is a policy, the implications that arise can be very large. As Olson pointed out, the lobbying process can have a colossal impact because it causes the decision-making run very slowly and the economy ultimately cannot respond quickly to changes and new technologies(Olson, 1982).

More clearly, Krugman & Obstfeld (2003)explained that rent-seeking activities, such as lobbying for licenses or permits, will distort resource allocation, making the economy inefficient. This is the case with everyday examples common in developing countries, where government officials sell their positions to recruit workers. When the government official receives money in return for his services in entering someone into an employee without adequate competence, the implication is that the country's (economic) performance will be bad because it is handled by incompetent employees(Tullock, 1980). In this category, rent-seeking behaviour not only deviates the allocation of economic resources, but also directly erodes the opportunity to achieve higher economic efficiency. Therefore, every economic policy that is made, according to a political perspective, must first be analysed to what extent the policy has the potential to lead to rent-seeking behaviour / corrupt activities(Yustika, 2008).

Several things can be concluded from the explanation of the rent seeking behaviour above. First, that the community will allocate resources to capture property rights opportunities offered by the government. At this point, the possibility of the emergence of rent-seeking behaviour is very large. Of course, in economic analysis, it is irrelevant to discuss whether these rent-seeking activities take the form of illegally or legally, although corrupt activities or other illegal activities can reduce the legitimacy of the government. Second, that every group or individual will definitely try to maintain their advantageous position. The implication is that political equilibrium may be able to survive in the long term because there will always be new pressure groups trying to get special facilities as well. Third, that within the government itself there are different interests. In other words, the government's interest is not singular. In this context, ideology becomes an important determinant that will guide the shape of government interests(Ito & Krueger, 2000).

Methodology

This research is a quantitative research using panel data regression. The data used in this study is secondary data, published by The Heritage Foundation, World Bank, Worldwide Governance Indicators, International Monetary Fund. This study uses 4 independent variables, consist of Economic Freedom, Political Stability, Natural Resources Rent, and Economic Growth as a proxy for foreign investment as the dependent variable. The scope of this research covers 9 ASEAN member countries using 15 years of data from 2005 to 2019. To do panel data regression, it is necessary to choose the best method used for research. Chow, Hausman and LM Tests were conducted to determine whether it is better to use the Pooled Least Square (PLS), Fixed Effects Model (FEM), or Random Effect Model (REM) method.

Results and Discussion

Based on descriptive statistics, it is known that the average FDI in 9 ASEAN member countries amounting to 409,224,6816 USD. The highest FDI was 24,93,551,748 USD in Indonesia in 2019, while the lowest of -150,550,827.3 USD occurred in Brunei Darussalam in 2016. The average value of economic freedom was 60,86889 points.Economic freedom of was 74.5 points in Malaysia in 2018 and the lowest economic freedom was in Myanmar in 2015. The average value of natural resources rents was 5.33%. The highest natural resource rent is in Brunei Darussalam in 2018 and the lowest at 0.61% was in the Philippines in 2016. The country with the highest political stability or 78.77 points was in Brunei Darussalam in 2018 and the least political stability was in Myanmar, especially in 2019. The average economic growth in 9 ASEAN countries is 6.3% with the highest economic growth in Singapore and the lowest in Myanmar.

After conducting the Chow and Haussman tests, the best and most suitable model to express this economic phenomenon is the Random Effect Model (REM), with the following equation:

$$LogFDIit = 16{,}85252 + 0{,}078340EF*it + 0{,}016950SP*it - 0{,}054348NR*it + 0.057707PE*it$$

From the results of these equations, it can be interpreted that simultaneously economic freedom and political stability are 2 elements in institutional factors in ASEAN countries as well as natural resource rents and economic growth have a significant (*) influence on the entry of foreign investment which is proxy by the value of FDI to 9 ASEAN countries. While partially, it is known that economic freedom is able to increase the interest of foreign investors to enter 9 countries in ASEAN. If economic freedom in the ASEAN region is increased by 1 point, ceteris paribus, then foreign investment that will enter the 9 ASEAN countries will increase by 0.078 million US$. Economic freedom is able to provide a wide space for investors, entrepreneurs and the public to work, produce goods and services, trade, and invest according to personal choices. The government can reduce control over economic activity by liberalizing trade through various regulations and laws that are conducive but still provide protection for private property rights, business investment and trade growth. The results of this study are supported byDuarte et al.(2017) who found that the lack of government intervention and free markets and fair competition provide great opportunities for investors and entrepreneurs to try new ideas. Economic Freedom Published by Heritage Foundation based on elements including Property Right, Government Integrity, Tax Burden, Government Spending, Business Freedom, Labour Freedom, Monetary Freedom, Trade Freedom, Investment Freedom, Financial Freedom. According to Heritage Foundation/Wall Street Journal (2003)to attract investors, the host country government must improve the investment climate in the country with various economic freedom policies such as lowering average tariffs, eliminating non-tariff barriers, reducing tax rates, reducing government ownership of businesses and industries. suppress inflation, lift restrictions on foreign ownership of resources, liberalize the banking and financial sector enabling wages and market prices, secure private property rights and an independent judicial system, reduce excessive regulatory burdens, and disrupt black market activity.

Apart from economic freedom, partially, the relatively stable condition of political stability in 9 ASEAN countries is able to influence the interest of foreign investment to enter this region. Investors are very sensitive to political issues in a country Jafari Samimi et al.(2013), when political stability in a country increases, by 1 point, it will encourage the flow of foreign investment into 9 ASEAN countries by 0.0169 million dollars. Unstable politics will reduce investor distrust as Kurecic & Kokotovic (2017) found that political instability in a country will reduce investor confidence and to regain it, government should be able to create political stability throughout stable, safe and conducive government through consistent and sustained investment policies. In Institutional Economic It is happened in Myanmar in which political stability is low. Theory by North stated that other formal institutional factors including political stability and handled corruption have an important role in increasing investor confidence and influencing investment inflows, evenShahzad et al.(2012) added that corrupt behaviour will exacerbate the entry of investment into a country. According to Jiang & Martek (2021) political risks in developing countries such as ASEAN tend to be greater than in developing countries but with varied effects.

The results of this study also found that investors are less interested in investing in BrunaiDarusalam in which the rental price for natural resources is relatively expensive compared to other regions plus with the low quality of natural resources. One of the motives for investors to enter a country is motivated by the natural resources seeking motive, where the motivation of investors to invest their capital in a country is to obtain relatively cheap natural resources with high quality. If the natural resource lease in 9 ASEAN countries increases by 1 US$, the inflow of foreign investment will increase by 0.05 million US$. The results of this study are in accordance with the Rodrigo Paton (2018)which also found the same thing that the rental price of mineral resources is negatively correlated with the entry of foreign investors. even according toElheddad, (2016) the abundance of natural resources in a country causes symptoms of Dutch disease which has an impact on investment in non-natural resource sector hampered.The failure of government institutions that cannot maintain natural resources and manage budget allocations efficiently causes the benefits of the existence of natural resources to be low even if allowed to continue, the country is headed for severe natural resource damage. The results of this study are supported byNdikumana & Sarr (2019) who found that when the quality of institutions in a low country, due to high corruption, investors tend to exploit natural resources and this high exploitation activity will result in high costs of natural resource recovery.

The results of the study also found that high economic growth in 9 ASEAN countries was able to increase the interest of foreign investors to enter this region. With a high level of per capita income as a result of growth, it will affect people's income, purchasing power and aggregate production. These factors will increase the aggregate demand for goods and services. The profit of entrepreneurs and the rate of return on investment will increase along with the high demand for goods and services and the economic progress of a country.

Conclusion

The result of this study shows that the strategic posture can make it easier for companies to carry out activities and corporate social responsibility. The existence of this strategic unit that handles social activities becomes smooth. This for the company will be a motivation to report its activities to fulfill the company's obligations for its business which has an impact on the environment. Therefore, the company tries to maintain professionalism in its activities.

The result of this study indicates that good economic performance will facilitate the implementation of the company in operation. This is because companies that have good performance will be able to increase company profits. The company's profit can finance all activities including social responsibility activities. Therefore, the company always strives to achieve good performance and good performance will increase its social responsibility activities and disclosures.

The result of this study shows that the disclosure of corporate social responsibility can be increased by assessing the special interest groups. Because this assessment will be used by the company to carry out several activities that must be carried out to meet stakeholder interests.

The result of the study concluded that the strength of stakeholders, namely creditors, reduces the company's ability to carry out activities and disclose corporate social responsibility. This shows that companies that have high obligations or debts to creditors must pay principal and interest which will reduce profits. Therefore, companies that have high debt will reduce the implementation of corporate social responsibility disclosures.Furthermore, the company needs to considermaintaining debt properly.

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