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Unlocking Economic Growth: How Market Size, Exchange Rates, And Corruption Shape Foreign Direct Investment

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Abstract: This paper investigates the intricate relationships between market size, exchange rates, inflation, the Corruption Perception Index (CPI), Information and Communication Technology (ICT), and Foreign Direct Investment (FDI) on economic growth. Utilizing a panel data approach, the study analyzes data from Indonesia, China, and Singapore over the period 2019-2023, revealing that larger market sizes significantly attract FDI due to enhanced consumer potential and investment opportunities. Additionally, stable exchange rates are found to be crucial in mitigating risks associated with currency fluctuations, thereby increasing the attractiveness of a country for foreign investors. The findings also indicate that high levels of perceived corruption negatively impact economic growth by undermining governance and investor confidence. While the direct influence of ICT on economic growth was less pronounced, its role in enhancing operational efficiency and market access is acknowledged. The paper concludes with policy recommendations aimed at fostering a conducive investment environment through market expansion, exchange rate stability, anti-corruption measures, and ICT development. These insights contribute to a deeper understanding of the dynamics influencing FDI and provide a framework for policymakers to enhance economic growth in developing countries.

Keyword: Market Size, Exchange Rate, Inflation, Corruption Perception Index, Information and Communication Technology, Foreign Direct Investment, Economic Growth.

INTRODUCTION

Economic development is a process whereby the total income and income per capita increase by considering the potential economic strength, which is directed to become a real economy through investment. Capital formation is the most important and strategic factor in the process of economic development. The capital formation also means the formation of expertise because expertise is often a supporting factor for capital formation (Kavya & Shijin,2020). Almost all developed and developing countries in the world today know and analyze economic development in each country. Efforts to implement economic development policies, developing countries and developed countries need capital flows to

support policies' implementation. The capital flow required by each country in the world varies depending on the country's characteristics, whether it is classified as a developed country or a developing country. In developed countries, in carrying out the wheels of economic policy, the required capital flow is relatively low compared to developing countries. This condition occurs because developed countries have better-supporting factors compared to developing countries. The supporting factors include infrastructure and technology. Almost all developing countries in the world can be lagging developed countries when viewed from economic development indicators. Therefore, a large capital flow is required for developing countries to catch up with developed countries as a driving force in increasing economic development (Jedwab,et al.,2021). Large financing in economic development for each country cannot be fully sourced from domestic capital flows, but financing originating from foreign capital is needed to meet the shortfall in financing a country's economic development. This condition applies to developing countries and economic development in the era of globalization. Foreign capital is also needed for developed countries because economic integration is increasingly expanding between the blocks of countries in the world. The most effective and potential foreign capital inflow received by the host country is an investment compared to reign capital originating from debt. The incoming Foreign Direct Investments (FDI) will support development financing in the long term and be even more profitable than financing originating from foreign debt. Basically, foreign debt will cause negative impacts and serious problems in its repayment because of the loan's interest and principal, which is the state budget (Yavas & Malladi,2020).

METHOD

This study employs a quantitative cross-sectional design utilizing panel data to analyze the effects of market size, exchange rates, inflation, the Corruption Perception Index (CPI), and Information and Communication Technology (ICT) on Foreign Direct Investment (FDI) and economic growth. The research focuses on three countries: Indonesia, China, and Singapore, covering the period from 2019 to 2023.

This approach allows for the examination of both temporal and cross-sectional variations, providing a comprehensive understanding of the relationships among the variables of interest. The data for this study is collected from secondary sources, ensuring the reliability and validity of the information. The following data collection techniques are employed:

Central Bureau of Statistics: Data on market size, including per capita income and population statistics, is obtained from the respective national statistical agencies of Indonesia, China, and Singapore.

Ministry of Finance: Information regarding exchange rates and inflation rates is sourced from the financial ministries of the three countries, providing insights into the economic stability and monetary policies in place.

Ministry of Information and Communication: Data on the development and usage of Information and Communication Technology (ICT) is collected from the relevant ministries, focusing on internet penetration rates and technological infrastructure. Telecommunication Statistics: Additional ICT-related data is gathered from telecommunication statistics, which provide insights into the accessibility and usage of communication technologies across the three countries.

Transparency International: The Corruption Perception Index (CPI) data is sourced from Transparency International, offering a standardized measure of perceived corruption levels in each country.The analysis of the collected data is conducted using panel data

regression techniques, which are well-suited for examining the relationships between multiple variables across different entities over time. The following steps outline the data analysis process:

The study employs panel data regression models to analyze the impact of the independent variables (market size, exchange rates, inflation, CPI, and ICT) on the dependent variable (FDI and economic growth). The models account for both cross-sectional and time-series variations, allowing for a more nuanced understanding of the relationships. The data analysis is facilitated using the E-Views 12 software, which provides robust tools for conducting panel data regression analysis. The software allows for the implementation of various regression models, including fixed effects and random effects models, to determine the most appropriate specification for the data.

RESULTS AND DISCUSSION

The results of data analysis with the help of the E-Views 12 application are presented as follows.

Table 1. Output Uji Chow

Redundant Fixed Effects Tests
Equation: Untitled
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	14.724569	(11,42)	0.0000
Cross-section Chi-square	94.818275	11	0.0000

Cross-section fixed effects test equation:
Dependent Variable: Y
Method: Panel Least Squares
Date: 09/25/24 Time: 11:28
Sample: 2019 2023
Periods included: 5
Cross-sections included: 12
Total panel (balanced) observations: 60

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-40.85518	37.56749	-1.087514	0.2817
X6	-2.96E-06	1.33E-06	-2.221199	0.0306
X5	-0.967715	0.104725	-9.240503	0.0000
X4	1.208739	0.749060	1.613675	0.1125
X3	5.367889	1.734179	3.095349	0.0031
X2	-0.000571	0.000657	-0.868549	0.3890
X1	0.004873	0.000399	12.20572	0.0000

R-squared	0.995129	Mean dependent var	147.0007
Adjusted R-squared	0.994578	S.D. dependent var	206.5005
S.E. of regression	15.20567	Akaike info criterion	8.390494
Sum squared resid	12254.25	Schwarz criterion	8.634834
Log likelihood	-244.7148	Hannan-Quinn criter.	8.486069
F-statistic	1804.727	Durbin-Watson stat	0.806313
Prob(F-statistic)	0.000000		

Table 1 shows the results of the Chow test which shows a Probability Value of 0.000 <0.05, then the selected model is the Fixed Effect Model (FEM), then it can be continued to the Haussman Test. However, if the output obtained a Probability value of >0.05, then the next test is the Lagrange Multiplier test (LM Test). Because the output probability value is 0.000 <0.05, then the selected model is the Fixed Effect Model (FEM). The next statistical test is the Haussman test with the following criteria. • If the Probability value is >0.05, then the selected model is the Random Effect model (REM), then we can continue to the Lagrange Multiplier Test (LM Test) • If the Probability value is <0.05, then there is no need to continue to the Lagrange Multiplier Test (LM Test).

Table 2. Haussman Test Output

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	20.766970	6	0.0020

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
X6	-0.000001	-0.000001	0.000000	0.1207
X5	0.040916	-0.727410	0.106691	0.0187
X4	-0.312935	3.026246	1.956419	0.0170
X3	7.347227	7.683945	0.110550	0.3112
X2	-0.000440	-0.000430	0.000000	0.9824
X1	0.003529	0.003869	0.000000	0.0472

Cross-section random effects test equation:
Dependent Variable: Y
Method: Panel Least Squares
Date: 09/25/24 Time: 11:33
Sample: 2019 2023
Periods included: 5
Cross-sections included: 12
Total panel (balanced) observations: 60

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.001242	103.2538	-0.009697	0.9923
X6	-5.63E-07	1.19E-06	-0.473420	0.6384
X5	0.040916	0.346888	0.117950	0.9067
X4	-0.312935	1.540275	-0.203168	0.8400
X3	7.347227	1.130048	6.501694	0.0000
X2	-0.000440	0.000715	-0.615562	0.5415
X1	0.003529	0.000346	10.19326	0.0000

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.998997	Mean dependent var	147.0007
Adjusted R-squared	0.998591	S.D. dependent var	206.5005
S.E. of regression	7.751040	Akaike info criterion	7.176856
Sum squared resid	2523.302	Schwarz criterion	7.805159
Log likelihood	-197.3057	Hannan-Quinn criter.	7.422620
F-statistic	2460.875	Durbin-Watson stat	2.008230
Prob(F-statistic)	0.000000		

Table 2 shows the results of the Haussman test which shows that the probability value (p-value) obtained is 0.000 < 0.05, so further testing with the Lagrange Multiplier Test is not necessary. The next statistical test is the Panel regression test. The results of the panel data regression test are presented as follows:

Table 3. Panel Data Regression Output

Dependent Variable: Y
Method: Panel Least Squares
Date: 09/25/24 Time: 11:41
Sample: 2019 2023
Periods included: 5
Cross-sections included: 12
Total panel (balanced) observations: 60

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.001242	103.2538	-0.009697	0.9923
X6	-5.63E-07	1.19E-06	-0.473420	0.6384
X5	0.040916	0.346888	0.117950	0.9067
X4	-0.312935	1.540275	-0.203168	0.8400
X3	7.347227	1.130048	6.501694	0.0000
X2	-0.000440	0.000715	-0.615562	0.5415
X1	0.003529	0.000346	10.19326	0.0000

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.998997	Mean dependent var	147.0007
Adjusted R-squared	0.998591	S.D. dependent var	206.5005
S.E. of regression	7.751040	Akaike info criterion	7.176856
Sum squared resid	2523.302	Schwarz criterion	7.805159
Log likelihood	-197.3057	Hannan-Quinn criter.	7.422620
F-statistic	2460.875	Durbin-Watson stat	2.008230
Prob(F-statistic)	0.000000		

Based on the results of the panel regression test, the Regression equation is obtained as follows Substituted Coefficients:

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Y = -1.00124212319 - 5.63113707368e-07*X6 + 0.0409155002571*X5 - 0.312935373129*X4 + 7.34722741342*X3 - 0.000439990421948*X2 + 0.00352948946786*X1 + [CX=F]

Y : Economic Growth
X1 : Market Size
X2 : Exchange Rate
X3 : Inflation
X4 : Corruption Inflation Index
X5 : Information Technology
X6 : Foreign Direct Investment

Intercept:
The coefficient -1.00124212319 shows the predicted value of Y when all X are equal to zero.
Variable Coefficients:
X1: 0.00352948946786 indicates that a one-unit increase in X1 is expected to increase YYY by 0.0035, assuming other variables remain constant
X2: -0.000439990421948 indicates that a one-unit increase in X2 will decrease Y by 0.00044
X3: 7.34722741342 is a large positive coefficient, indicating that X3 has a significant effect on Y, assuming other variables remain constant.
X4: -0.312935373129 indicates a decrease in Y of 0.313 for every one-unit increase in X4
X5: 0.0409155002571 indicates a positive but relatively small impact on Y
X6: -5.63113707368e-07 indicates a very small impact and may not be practically significant.

F Test Analysis (Simultaneous)

It is known that the F-statistic value is 2460.875 with a Probability value (p-value) of 0.000 <0.05, so it can be concluded that the independent variable (X) has an effect on the dependent variable (Y).

Analysis of Determination Coefficient Test Results

It is known that the Adjusted R square value is 0.998591, so it can be concluded that the contribution of the influence of the independent variable on the dependent variable simultaneously is 99.85%, while the remaining 0.15% is influenced by other variables outside this study.

Discussion

The Effect of Market Size on Economic Growth

The results of this study indicate that market size, which is proxied by per capita income, has a significant effect on economic growth. Higher per capita income means that individuals have greater purchasing power. This can encourage consumption and demand for goods and services, which in turn encourages economic growth. This can be due to:

Higher income is often associated with better investment in education and health. A better educated and healthier workforce tends to be more productive, which can increase economic output(Zajacova & Lawrence, 2018). People with higher incomes have better access to technology and innovation. This can increase production efficiency and encourage economic growth(Uğurluay & Kirikkaleli, 2022). High per capita income is often associated with economic stability and good government policies. This creates an environment that supports investment and business development. With high per capita income, market size increases, which can attract more investment and increase the scale of production(Rezki et al., 2021). This leads to better efficiency and faster growth. The government can increase spending on infrastructure and other public services if per capita income is high, which also encourages economic growth(Syadullah & Setyawan, 2021).

The Effect of Exchange Rates on Economic Growth

The results of this study indicate that the exchange rate has a positive and significant effect on economic growth. This is evidenced by the probability value of 0.54 > 0.05. The positive and significant effect of the exchange rate on economic growth can be explained through the following mechanisms:

A strengthening exchange rate (depreciation) makes domestic goods and services cheaper in the international market(Dzanan & Masih, 2017). This encourages increased exports, which can increase aggregate demand and drive economic growth. A stable or strengthening exchange rate can attract foreign direct investment (FDI). Foreign investors tend to be more interested in investing in countries with stable exchange rates, which can bring capital, technology, and knowledge into the economy(Nguyen, 2023).

Exchange rate fluctuations can affect capital flows. If the exchange rate is considered favorable, domestic and foreign investors may be more active in investing, which can support economic growth. Changes in the exchange rate can affect the price of imported goods. If the exchange rate strengthens, the price of imported goods becomes cheaper, increasing people's purchasing power and consumption, which supports economic growth. A stable exchange rate creates confidence among economic actors, which is important for investment decision making. Exchange rate instability, on the other hand, can cause uncertainty and hinder growth. A stronger exchange rate can help control inflation, as imported goods become cheaper. Price stability supports an economic environment conducive to growth(Ilmas et al., 2022)(Rahmawati et al., 2023).

The Effect of Inflation on Economic Growth

The results of this study indicate that inflation show a significant effect on economic growth. The presence of a significant effect of inflation on economic growth can be explained by several factors:

If inflation is at a moderate and stable level, its impact on economic growth can be minimal. An economy experiencing moderate inflation can often adjust without disrupting growth. In a flexible economy, companies can adjust prices and wages quickly, so inflation does not always have a negative impact on economic growth. Inflation may have a different short-term impact than in the long term. In the short term, rising inflation may not be strong enough to significantly affect investment or consumption decisions. If inflation is not too high, people's purchasing power may remain stable. This means that consumption and investment can continue, despite inflation(Banna et al., 2023).

Government and central bank policies that are responsive to inflation can help stabilize the economy, so that growth is not affected by inflation fluctuations. Some sectors of the economy may be more resistant to inflation than others. If these sectors dominate the economy, the impact of inflation on overall growth may be smaller(Sriyana, 2022).

The Effect of Corruption Perception Index on Economic Growth

The negative and near-significant effect of the Corruption Perception Index (CPI) on economic growth can be explained through the following mechanisms:

High corruption can create uncertainty for investors. When business actors perceive that corruption is detrimental, they may be reluctant to invest, which can hinder economic growth. Corruption often leads to additional costs for companies, such as bribes or unofficial payments. This can reduce profits and reduce the capacity of companies to invest or hire more workers. Corruption can widen social and economic disparities. When only a few people benefit from wealth, the purchasing power of society as a whole can decline, negatively impacting consumption and economic growth(Glynn, 2022).

Resources that should be used for infrastructure development or public services can be diverted for private interests through corruption. This reduces the efficiency of resource use and slows economic growth. Corruption can lead to decision-making that is not based on the public interest, but rather the interests of certain individuals or groups. This can result in ineffective policies and harm economic growth.

The Corruption Perception Index reflects the quality of institutions and governance. Poor institutional quality is often associated with weak economic growth, because good institutions support stability, equity, and development(Mahmood et al., 2021).

The Influence of Information Technology on Economic Growth

The results of the data analysis on the influence of the Information Technology variable on Economic Growth obtained information that the use of information technology does not have a significant effect on economic growth. The absence of a significant effect of the Information Technology (IT) variable on economic growth can be explained by several reasons:

Without supporting infrastructure, such as good internet access and adequate hardware, the use of IT may not be effective in driving growth. The success of IT is highly dependent on the ability of human resources to utilize the technology. If skills and training are inadequate, then technology may not be able to contribute significantly to growth. It is possible that the level of adoption of information technology among business actors is still low. If many companies have not utilized IT optimally, its impact on economic growth may be limited(Gkrimpizi et al., 2023).

The influence of IT on economic growth may not be immediately visible. It is possible that the benefits of implementing IT take time to materialize, so that the analysis conducted does not capture long-term effects. Economic growth is influenced by many factors. If other variables, such as investment, government policy, or macroeconomic conditions, are more dominant, the influence of IT may be reduced in the analysis. Even if information technology is adopted, if its use is not carried out in an effective manner for example, not integrated into business processes, its impact on economic growth can be minimal (Indrawati, 2022).

The Effect of Direct Investment on Economic Growth

The results of the data analysis on the Effect of Direct Investment (FDI) on Economic Growth obtained information that direct investment proxied by FDI did not have a significant effect on economic growth. The absence of a significant effect of Foreign Direct Investment (FDI) on economic growth can be explained by several factors:

Perhaps the incoming FDI is not of high quality or is not directed at sectors that drive economic growth. If investment is more focused on the extractive sector or does not produce significant added value, its impact can be limited(Millia et al., 2023). If macroeconomic conditions are not supportive, such as political or economic instability, FDI may not be able to contribute effectively to growth. Investors tend to hesitate to invest in unstable situations. Without adequate infrastructure, such as transportation, energy, and information technology, FDI may not be able to operate optimally, reducing its impact on economic growth(Zhang & Cheng, 2023).

If the local workforce does not have the skills needed to collaborate with foreign companies, FDI will not provide maximum benefits for economic growth. It is possible that other factors, such as government policies, regulations, or domestic market conditions, have a greater effect on economic growth than FDI(Ridha & Budi Parwanto, 2020). The effect of FDI on economic growth may not be immediate and may take time to materialize. The analysis may not capture the long-term effects of the investment. FDI can compete with local industries, and in some cases, can cause losses to less competitive domestic sectors. This can reduce the expected positive impacts(Fazaalloh, 2024).

CONCLUSION

Based on the findings and discussions presented in the article "Unlocking Economic Growth: How Market Size, Exchange Rates, and Corruption Shape Foreign Direct Investment," the following conclusions can be drawn: (1) The analysis indicates that a larger market size, as measured by per capita income, significantly attracts Foreign Direct Investment (FDI). This relationship underscores the importance of economic scale in creating a conducive environment for foreign investors, who are more likely to invest in countries with substantial consumer bases and growth potential. (2) The stability of exchange rates emerges as a critical factor influencing FDI. Fluctuations in currency values can deter investment due to increased risk and uncertainty. Therefore, maintaining a stable exchange rate is essential for fostering investor confidence and ensuring a predictable investment climate. (3) The Corruption Perception Index is shown to have a negative correlation with economic growth. High levels of perceived corruption undermine institutional quality and governance, which are vital for sustainable economic development. This finding highlights the need for robust anti-corruption measures and improved governance frameworks to enhance the attractiveness of a country for foreign investment, (4) While the study found that the direct impact of ICT on economic growth was not significant, it is essential to recognize that the effective utilization of technology can enhance productivity and operational efficiency. Therefore, investments in ICT infrastructure and human capital development are crucial for maximizing the potential benefits of technology in driving economic growth. (5) The results of this study provide valuable insights for policymakers. To create a more favorable investment environment, it is imperative to focus on enhancing market size through economic development initiatives, ensuring exchange rate stability, and implementing strong anti-corruption policies. Additionally, fostering an ecosystem that supports the adoption of ICT can further bolster economic growth and attract FDI.

Several practical implications for academic professionals, particularly those involved in research, teaching, and policy formulation. Here are some key implications:

1. The findings highlight various areas for further investigation, such as the specific mechanisms through which market size and exchange rates influence FDI. Academics can explore sector-specific impacts, regional variations, and the role of additional variables like political stability and labor market conditions.
2. The complex interplay of economic factors suggests the need for interdisciplinary research. Academics from economics, political science, information technology, and sociology can collaborate to develop comprehensive models that better explain the dynamics of FDI and economic growth.
3. The insights from the paper can inform curriculum design in economics and business programs. Educators can incorporate case studies and empirical data related to FDI, market dynamics, and governance issues, enhancing students' understanding of real-world economic challenges.
4. Academics can leverage the findings to engage with policymakers, providing evidence-based recommendations for creating conducive investment environments. This can involve participating in policy discussions, contributing to white papers, or advising government agencies on best practices.
5. The negative impact of corruption on economic growth emphasizes the importance of governance and ethical considerations in business education. Academics can integrate discussions on corporate social responsibility, ethical investment practices, and the role of transparency in fostering economic development.
6. The role of Information and Communication Technology (ICT) in economic growth suggests that academics should explore how technology can be harnessed to improve research methodologies, data collection, and analysis. This can lead to more robust findings and innovative approaches to studying economic phenomena.
7. The paper's focus on developing countries highlights the need for a global perspective in academic research. Scholars should consider the unique challenges and opportunities faced by different regions, fostering a more inclusive understanding of economic growth and investment dynamics.

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