

**How is Inward Foreign Direct Investment Impacted by Control of Corruption and  
Democratic Status?**

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Abstract:

This paper researches the impact of corruption and democratic status on foreign direct investment inflows. The sample includes annual data for 98 high and low-income countries from the years 1995-2019. It was found that in high-income countries, rule of law, control of corruption, and government integrity were significant and positively correlated to FDI inflows. However, they were insignificant in low-income countries. Alternatively, democratic status was significant and positively correlated to foreign direct investment in low-income countries, but almost entirely insignificant in high-income countries.

### Introduction:

Since the 1990s, foreign direct investment (FDI), has increased and grown substantially in high and low- income countries (Saini and Singhania, 2015). Many factors contribute to an investor's decision concerning FDI inflows, including political determinants. However, recent research has indicated that, historically speaking, political determinants may not play as much as a role in the investor's decision (Biglaiser and Brown, 2004). This study aims to challenge and test this statement to determine if political determinants are indeed significant.

This study explores four political determinants: rule of law, control of corruption, government integrity, and democracy. Using a sample of high- and low-income countries from 1995 to 2019, the study analyzes the effects of these political determinants on FDI, controlling for macroeconomic variables. An analysis of the full sample found that rule of law, control of corruption, and democratic status were significant and positively correlated. However, determinants of foreign direct investment are much different for high and low-income countries. These determinants greatly affect an investor's decision; thus, the sample was split between high- and low-income countries to capture this difference. After splitting the sample between high and low-income countries, it was concluded that control of corruption, rule of law, and government integrity were significant and positively correlated to foreign direct investment in high-income countries. However, democratic status was not. Alternatively, in low-income countries, control of corruption, rule of law, and government integrity were insignificant, while democratic status was significant and positively correlated to foreign direct investment at the 1% level.

### Literature Review:

According to the OECD, "foreign direct investment (FDI) is a category of cross-border investment in which an investor in one economy establishes a lasting interest in- and a

significant degree of influence over- an enterprise in another economy” (OECD homepage, 2021). Literature suggests that while developing economies attempt to attract FDI for ways to increase investment and generate additional growth, FDI in developed economies assists in sustainable development and allows access to foreign firms (Saini and Singhania, 2015). However, despite the popularity of this subject, there is little consensus in terms of the determinants of FDI (Saini and Singhania, 2015). Even so, the World Bank has said that FDI is one of the most effective tools to help fight world poverty (Asiedu and Lien, 2010). FDI stimulates economic growth, increases employment, leads to infrastructure development, enterprise restructuring, and capital account relief (Ho and Rashid, 2011). Foreign direct investment is not always seen as a positive force in development. Foreign direct investment can create a more competitive marketplace, ultimately crowding out domestic investors. Also, it could potentially lead to a more corrupt government (Biglaiser and Brown, 2004). Some researchers have attempted to examine FDI through political determinants, while others view it more economically. Some of these political and economic factors are examined further to understand the topic and build a background for further research.

### **Political Determinants**

Many have attempted to “rank” governments on quality based on a few factors: the wealth of a country, ethnic diversity, religion, and stability (Staats and Biglaiser, 2012; Kim, 2010). The quality of government is essential for the private sector, and thus FDI which makes up a portion of the private sector. The private sector represents the portion of the economy that is not directly government owned. A better quality of government will lead to a better private sector. FDI is more sensitive to the quality of government, however, because foreign investors have more options in location than domestic investors. Foreign investors evaluate the risk more.

If the quality of government is not high, foreign investors will look elsewhere. This has been shown to affect FDI inward performance recently in countries such as China and Russia (Kim, 2010). It also is vital to ensure the government can, and will, give credible assurance to the investor without significant interference and changes in laws over time (Staats and Biglaiser, 2012; Biglaiser and Brown, 2004). However, a great deal of research also concludes that while a quality government has potential, many investors will take the risk and invest in a politically unstable economy (Staats and Biglaiser, 2012).

Kim (2010) found that countries with a higher level of government corruption and a lower level of democracy did attract more FDI in a sample of 28 countries. This means that more investors are taking on more risk and investing in countries with less stability, some being developed. It was also shown that some investors are more attracted to countries with fewer political rights. This is likely because investors can influence more politically speaking, meaning there may be a higher level of corruption. This is a controversial idea in literature. Furthering this thought, one of the questions discussed by Asiedu and Lien (2010) relates to democracy. More specifically, does having a democratic government attract and facilitate more FDI inflows? According to this research, the longevity of a government implies a more stable business environment, which would be more attractive for investors when it comes to FDI inflows. In this case, that means democracies would be less appealing since leaders usually only serve a term or two. Thus, there is a large turnover ratio compared to other forms of government. Turnover, in general, when it comes to FDI is usually unattractive (Staats and Biglaiser, 2012; Asiedu and Lien, 2010). Democracies are less attractive because the government usually controls highly attractive resources. This means, if one yearns to access these resources, the investor will need a closer relationship with the leaders. These relationships are more challenging to have in a

democratic government (Asiedu and Lien, 2010). Overall, Asiedu and Lien (2010) concluded that in countries where natural resources were a small export, democracy boosts the overall FDI. However, in countries where the exports of natural resources were high, there was a negative effect on FDI.

The debate between a democratic government and an authoritarian one is common. As previously mentioned, investors would rather avoid turnover. Due to the lack of consistent elections, an authoritarian government is expected to possibly protect foreign interests better if the host country's government supports foreign investment (Biglaiser and Brown, 2004). However, investors want assurance. The lack of an impartial court in these governments may deter investors. Both government types have their pros and cons, and it is individual to the investor and potential country which type of government is "better" for FDI inflows. Biglaiser and Brown (2004) show that investors do not prefer a particular government type but rather how governments operate. This includes policies such as privatization, education, and spending programs.

### **Macroeconomic Determinants**

Economic factors are probably the most frequently studied in terms of FDI. These factors are extensive, but there are a few commonly researched: economic growth, degree of openness, inflation, exchange rate, manufacturing output, consumer income, infrastructure, employment, tourism, and skills and knowledge (Ho and Rashid, 2011; Williams, 2015; Boateng, Hua, Nisar, & Wu, 2015). The motivations behind foreign direct investment can differ in development vs. developing countries. This can alter the relationship between some of these variables and FDI based on whether the sample is a developed or developing economy. According to Saini and

Singhanian (2015), labor cost, tax regimes, and GDP have had both negative and positive effects on FDI depending upon the economic and political environment of the host country.

### *Developing Countries*

Developing countries have qualities that prove to be attractive to some investors. Many researchers focus on groups of developing countries. For example, a great deal of work has been done on developing countries in Africa, Asia, and South America. Developing countries have attempted to attract more FDI to boost their economy. However, competition among these countries has dramatically increased with so many yearning for the benefits. Economic reforms have become one of the most impactful advances in attracting FDI. From 1992 to 2001, almost 95% of the economic reforms proposed and adopted by developing countries would help increase FDI (Williams, 2015; Yeboua, 2021). Governments in developing countries recognized they needed outside investments to develop their economies, gain relief from foreign exchange shortages, and further their technological growth (Treviño and Mixon, 2004).

Studies commonly group developing economies by location because of similar governmental policies as well as other factors. Latin America, for example, was subject to many hardships in the mid-1900s, which influenced their economic reforms to attract more FDI. After both oil crashes in the 1970s and the debt crisis in the 1980s, many Latin American countries began to liberalize their policies (Williams, 2015; Treviño and Mixon, 2004). Many believe that these changes could attract more FDI into the area. Based on Williams' (2015) research, while debt, infrastructure, growth, and inflation all behaved as expected, it was found that good governance had a negative association with FDI in Latin America. However, this is likely due to the type of FDI present. It is known that the democratic governments are relatively weak in some of these Latin American developing countries, however, making property rights weak as well

(Williams, 2015). Latin American countries have different determinants than other developing countries, which is why Williams (2015) split the research sample between Latin American and non-Latin American countries. Latin American countries were found to be more attractive to investors in terms of stock of infrastructure, debt, and constraints on the executive (Williams, 2015). Williams (2015) used constraints on executive, finding it was significant and negatively correlated with foreign direct investment inflows in non-Latin American countries, which indicated that countries that lacked democracy and were relatively poor had almost nonexistent property rights. It was concluded that Latin American developing countries should take advantage of their location, increasing seaports and airports, creating more international accessibility, and potentially attracting more FDI inflows (Williams, 2015).

When studying FDI, China is a unique example as it is slated to be transitioned from a developing country to a developed country in 2023 (Larson, 2021). China also saw an explosion in FDI in recent decades. China is so unique that the determinant findings affecting China may help determine FDI factors worldwide (Cheng and Kwan, 2000). Investors who chose a location like China consider access to national and regional markets, wage costs and labor productivity, education, unemployment, the degree of unionization, policy toward FDI, including tax rates and infrastructure. While China is still considered a developing country, determinants of FDI are rather like those in the United States and other developed countries (Cheng and Kwan, 2000).

### *Developed Countries*

Developing countries are often thought about first in terms of FDI inflows, but there are many FDI inflows in developed countries. Many empirical studies have shown that countries with a more developed infrastructure are favorable in investment (Ho and Rashid, 2011). Further, knowledge is more important as well. In Poland, for example, the main drivers of FDI are



knowledge and market factors. European countries are also seen to have a somewhat positive correlation between GDP and FDI (Ho and Rashid, 2011). However, the instability of exchange rates appeared to have a negative effect on FDI in the same study. Trade openness is another important determinant for investors. Typically, investors prefer a more open country when it comes to trade. In recent years, developed countries that have recently added more economic reforms have decreased FDI inflows. For example, tax rates and trade restrictions have led to a decrease in FDI in the United States (UNCTAD, 2018). Generally, a liberal trade reform promotes an environment welcoming and friendly for investors (Boateng, Hua, Nisar, Wu, 2015).

Developed countries can also be subject to location specific FDI. Norway, which recently discovered oil deposits, has seen a significant increase in FDI (Boateng, Hua, Nisar, Wu, 2015). Due to this increase in FDI, Norway is also an excellent case to analyze FDI determinants in developed countries. In a study by Boateng, Hua, Nisar, and Wu (2015), the relation between GDP, inflation, trade openness, and FDI was significant. This relation indicated that as Norway experiences economic growth, an investor would be attracted to the country for the increase in GDP, low inflation, and trade openness. This is common for other developed countries as well. It was also found that low unemployment in Norway negatively influenced FDI. Investors are attracted to available labor, leading them to prefer a high unemployment rate. Also, a high unemployment rate indicates that workers would be more inclined to accept a lower wage (Boateng, Hua, Nisar, Wu, 2015).

The determinants of FDI are complex and varied, leaving many new avenues for additional study. A commonly cited paper by Schneider and Frey (1985) stated that studies that do not include political and economic viewpoints lack a coherent picture. Unfortunately, many

disregard political viewpoints or treat them as a side point. While more research has been done on political determinants since 1985, there is still a gap in the research when comparing the developed, or high-income, vs. developing, or low-income, countries.

### Data and Methodology:

### **Regression Equations**

$$\begin{aligned}
 FDI_{i,t} = & \alpha + \beta_1 \text{Ln GDP per Capita}_{t-1, i, t} + \beta_2 \text{Ln Population}_{t-1, i, t} \\
 & + \beta_3 \text{General Government Final Consumption Expenditure}_{t-1, i, t} \\
 & + \beta_4 \text{Exchange Rate Volatility}_{t-1, i, t} + \beta_5 \text{Trade Openness}_{t-1, i, t} \\
 & + \beta_6 \text{Mean Years of Schooling}_{t-1, i, t} + \beta_7 \text{Domestic Investment}_{t-1, i, t} + \beta_8 \text{Inflation}_{t-1, i, t} \\
 & + \beta_9 \text{Ln Tourism}_{i, t} + \beta_{10} \text{democracy}_{i, t} + \mu_{i, t}
 \end{aligned}$$

$$\begin{aligned}
 FDI_{i,t} = & \alpha + \beta_1 \text{rule of law}_{i, t} + \beta_2 \text{Ln GDP per Capita}_{t-1, i, t} + \beta_3 \text{Ln Population}_{t-1, i, t} \\
 & + \beta_4 \text{General Government Final Consumption Expenditure}_{t-1, i, t} \\
 & + \beta_5 \text{Exchange Rate Volatility}_{t-1, i, t} + \beta_6 \text{Trade Openness}_{t-1, i, t} \\
 & + \beta_7 \text{Mean Years of Schooling}_{t-1, i, t} + \beta_8 \text{Domestic Investment}_{t-1, i, t} + \beta_9 \text{Inflation}_{t-1, i, t} \\
 & + \beta_{10} \text{Ln Tourism}_{i, t} + \beta_{11} \text{democracy}_{i, t} + \mu_{i, t}
 \end{aligned}$$

$$\begin{aligned}
 FDI_{i,t} = & \alpha + \beta_1 \text{government integrity}_{i, t} + \beta_2 \text{Ln GDP per Capita}_{t-1, i, t} + \beta_3 \text{Ln Population}_{t-1, i, t} \\
 & + \beta_4 \text{General Government Final Consumption Expenditure}_{t-1, i, t} \\
 & + \beta_5 \text{Exchange Rate Volatility}_{t-1, i, t} + \beta_6 \text{Trade Openness}_{t-1, i, t} \\
 & + \beta_7 \text{Mean Years of Schooling}_{t-1, i, t} + \beta_8 \text{Domestic Investment}_{t-1, i, t} + \beta_9 \text{Inflation}_{t-1, i, t} \\
 & + \beta_{10} \text{Ln Tourism}_{i, t} + \beta_{11} \text{democracy}_{i, t} + \mu_{i, t}
 \end{aligned}$$

$$\begin{aligned}
FDI_{i,t} = & \alpha + \beta_1 \text{control of corruption}_{i,t} + \beta_2 \text{Ln GDP per Capita}_{t-1, i,t} + \beta_3 \text{Ln Population}_{t-1, i,t} \\
& + \beta_4 \text{General Government Final Consumption Expenditure}_{t-1, i,t} \\
& + \beta_5 \text{Exchange Rate Volatility}_{t-1, i,t} + \beta_6 \text{Trade Openness}_{t-1, i,t} \\
& + \beta_7 \text{Mean Years of Schooling}_{t-1, i,t} + \beta_8 \text{Domestic Investment}_{t-1, i,t} + \beta_9 \text{Inflation}_{t-1, i,t} \\
& + \beta_{10} \text{Ln Tourism}_{i,t} + \beta_{11} \text{democracy}_{i,t} + \mu_{i,t}
\end{aligned}$$

By examining country panel data from 1995 to 2019, this study will analyze the relationship between FDI inflows, democratic status, rule of law, government integrity, and control of corruption. This study uses the work of Biglaiser and Brown (2004), a paper written on the political stability in relation to FDI in Latin America, as a primary source. Reminiscent of their research, this study uses similar political variables as well as some macro-economic variables. There are many similarities between the research, and thus, I hypothesize this study will yield similar results in terms of my variables of interest. However, I use significantly more variables, which may lead to alternative results. Overall, I hypothesize that democratic status and a decrease in corruption will lead to an increase in FDI inflows.

The sample for this study consists of 98 countries from all over the world. These countries were the only countries that consistently had data available for all four variables of interest dating back to 1995, especially regarding FDI inflows and the main variables of interest. Again, the time series for this data is from 1995 to 2019, covering 24 years. These years were also determined based on the data available. It is difficult to see why investors make the decisions they do over a short period. Thus, a little over two decades of data should help see the political impacts in determining FDI inflows.

The dependent variable in this study is foreign direct investment (FDI) inflows. According to the UN, FDI is an investment for acquiring an interest in or control over a business, trade, or enterprise in a foreign or outside economy of the investor (FDI, 2021). More specifically, in this study, FDI inflows are defined as an inward direct investment made by a foreign investor in the reporting economy. FDI inflows are typically measured in a percentage form, and in this case, as a percentage of GDP. From the World Bank database, FDI inflows from 1995-2019 were gathered for each of the 98 countries present in the study.

After further analyzing the 98 countries in this sample, it became evident that they were very different economically and politically speaking. What would have been a major determinant in one country, Australia, for example, would not be the same for a low-income country in South America. Potential investors look at different factors when determining if a country would be a good investment. For this reason, the sample was examined as a whole but was also split between high- and low-income countries. Out of the 98-country sample, 35 were shown to be high-income, while 63 were categorized as low-income. This categorization was based on the current income classifications by the World Bank. This also allows the results of this study to be more comparable with others. While other literature examines developing or developed countries, it is uncommon to see a sample containing both.

### **Variables of Interest**

The first variable of interest is rule of law. According to the Worldwide Governance Indicators, rule of law “reflects the extent in which citizens and people have confidence in, and abide by, the rules of society” (Worldwide Governance Indicators, 2021). Many factors that go into rule of law including law enforcement officers, courts, property rights, and the likelihood of crime and violence. The Worldwide Governance Indicators measures range from -2.5 to 2.5. In

this case, -2.5 represents weak government performance and lack of confidence in government, while 2.5 represents strong government performance and confidence in government. It is common to see higher income countries performing better in this measure. For example, the United States in 2019 had a rule of law ranking of 1.46 and Venezuela in the same year had a ranking of -2.32. It is hypothesized that rule of law will have a positive correlation with FDI inflows. This is largely since investors will likely want to invest in a country with a more respected, strong government with more confidence from citizens. Further, with a stronger rule of law comes more protection from the government. Property rights are of major importance to investors. They want to insure they are making a safe investment. I hypothesize that rule of law will be insignificant in low-income countries based on the results of Biglaiser and Brown (2004), which they claim is largely due to the time it takes for investors to see a consistent change in political reforms. However, I believe it will be significant and positively correlated in the high-income country sample because of the investor's desire to protect their property rights. While this is also a goal in low-income countries, these countries have a more difficult time guaranteeing these rights. Biglaiser and Staats (2012) argued that in addition to wanting these rights, investors want to earn a profit on their investment. Therefore, in countries where there is not a strong rule of law in place, there are other factors that provide a higher incentive to investors.

The next variable of interest is government integrity. Government integrity represents the wiliness the government has to fulfill its obligations it has to the public. This creates a faith and trust in the government of a specific country. Government integrity is ranked from 0-100, 100 being the highest amount of integrity a government can have. This data comes from the Heritage Foundation's index for government integrity. Government integrity also goes hand in hand with

control of corruption. The more corrupt a government is, the more likely a country will have less governmental integrity. Again, a low government integrity provides little protection for potential investors. Biglaiser and Brown (2004) argued that it is so difficult to implement governmental policies, such as higher integrity, it takes years before investors notice a credible reform policy in low-income countries. It is hypothesized that, again, while this will likely have a little significance in low-income countries similar to the findings of Biglaiser and Brown (2004), it will be significant and positively correlated in high-income countries. Investors want that integrity which attracts them to the high-income countries that have a higher ranking, but as previously stated it is a lot harder to get in low-income countries. Government integrity, like rule of law, takes time to implement. Investors need to see consistency from a low-income government before they determine whether that government in question has high integrity.

Control of corruption was also found on Worldwide Governance Indicators. According to the Worldwide Governance Indicators, control of corruption “displays perceptions of the extent public power is exercised for private gain in a government” (Worldwide Governance Indicators, 2021). Corruption is a highly debated topic in literature as seen previously in this paper. Similar to rule of law, control of corruption is represented in an interval of -2.5 to 2.5. In this instance, -2.5 once again means weak government performance and higher corruption levels and the opposite is true for 2.5. Corruption is likely going to play a large role in FDI inflows. As discussed in the literature review, investors prefer a stable government with little to no corruption (Kim, 2010). Corruption can ultimately cost investors much more money in the long run. Thus, theoretically speaking a higher level of corruption will lead to a lower level of FDI inflows. Biglaiser and Staats (2012) claim that corruption increases risks for investors as new leaders come in and begin to prioritize their personal gains. However, in some cases it also can

be a positive determinant for investors if they have the same priorities as this new leader.

Overall, control of corruption is hypothesized to significant and positively correlated with FDI inflows in all samples.

The Polity2 score is treated as a dummy variable in this study. According to the Polity Project, the polity score reflects the democratic levels of authority within a country and displays any regime changes, as in a change in the political system, in countries with a population greater than 500,000. The polity2 has a ranking ranging from -10 to 10. The higher the ranking, the greater level of democracy within a country. As explained in the literature review, there is a lot of debate surrounding regime type when it comes to investors. However, it is hypothesized in this research that the greater level of democracy within a country, the more likely investors will want to invest. Democratic governments are likely to provide stability and credibility which will in turn attract investors. On the flip side, this could also mean less corruption, which could potentially negatively affect investors as seen in the literature review. Since this is a dummy variable, when the polity2 score is greater than 5, the country is considered a democratic state. Again, I hypothesize that for all samples, when it is true the country in question is more of a democracy, there will be a significant and positive correlation to FDI inflows.

### **Control Variables**

GDP per capita represents the gross domestic product per person in a country. GDP per capita is an important indicator of income. This data was gathered from the World Bank. For this study, GDP per capita is used from 1995-2019. GDP per capita is calculated in 2015 constant US dollars. Since it is a strong indicator of income, it is likely to have a positive correlation with FDI inflows in high-income countries. However, for investors searching for cheap labor, and thus

cheap wages, a higher GDP per capita would be unattractive. As a result, a higher GDP per capita in low-income countries is likely still significant, but negatively correlated with FDI inflows. GDP per capita can be subject to a large variance and have rather skewed data. The natural log is taken to eliminate some of this variance among the variable and create a more normally distributed variable. The variable was also lagged by one year in order to identify the time delay and forecast FDI inflows, depending on past GDP per capita data.

Population has different effects on different types of countries. Thus, making it likely it is also important in terms of FDI investments. A higher population typically indicates both a larger market size of consumers and a larger available labor force. Both factors usually would be attractive to investors. In a low-income economy, access to a relatively lower skilled population creates an attractive force for investors. In high-income countries on the other hand, typically indicates a larger market size, which again is attractive. In all economies, however, a higher population is usually a positive force. The population data was found using UNSTATS. Like GDP per capita, to avoid a large variance in the data, the natural log is taken for the sample and the variable is lagged by one year. For the reasons previously mentioned, it is likely population is significant in all samples, but negatively correlated in the full and low-income country sample and positively correlated with the high-income country sample.

Educational attainment is also an important indicator of a countries overall economic health. Education is typically considered a driver of human capital. To examine educational attainment closer, the mean years of schooling is evaluated. “Mean years of schooling shows the average number of years of education received by people ages 25 and older” (Human Development Reports, 2021). The variable is lagged by one year in order to identify the time delay and forecast FDI inflows, depending on past education data. Education can be associated



with skills and knowledge, which supports production. This is good for investors in terms of labor capability. However, in low-income countries, an increase in skills in knowledge leads to an increase in wages. For those investors seeking cheap labor, this increase in wages is unattractive. Thus, mean number of years of schooling can greatly affect investors and the cost of the investment they are making. For this reason, mean years of schooling is likely significant and negatively correlated for the full and low-income samples. On the other hand, an increase in education can be attractive if investors are looking solely at high-income countries making the opposite true of the correlation. This data was found in the United Nations Development Program Human Development Reports. It is used from 1995 to 2019.

Domestic investment is the investment in companies or industries in one's own country rather than in a foreign market. Domestic investment can pose as competition for FDI inflows. However, high domestic investment can also signal to investors that there will be a positive return on investment. Thus, it would make sense that an increase in domestic investment would in turn lead to an increase in FDI inflows. This means it will be significant and positively correlated with FDI inflows. It is likely, based on the behavior of domestic investment in low-income countries, that domestic investment in high-income countries will still be positively correlated, but less significant. Investors in high-income countries could possibly expect a better return no matter the domestic investment because of the protection of rights previously discussed. Also, investors want to be in high-income countries because of the market, so domestic investment is likely not as important of a factor. The variable is lagged by one year in order to identify the time delay and forecast FDI inflows, depending on past domestic investment data.

According to the OECD, general government final consumption expenditure is “all current government expenditure incurred by government in its production of non-market final goods and services” (OECD homepage, 2021). As this expenditure increases, this indicates that the government plays a larger role in the economy, which likely makes the country less attractive to potential investors. If government spending is higher, it could crowd out other sectors. Also, this increased involvement means the government may have to tax more. Some intervention is good, but there has to be a middle ground. In some developing countries, there was an increase in general government consumption expenditure because of the natural resources present. The government was using these resources to in term provide more social service programs for its citizens. Thus, it can be hypothesized that as central government final consumption expenditure increases in all samples, FDI inflows will decrease. This variable was lagged by one year to better match the expenditures with the inflows.

The more volatile the exchange rate is in a country, the riskier the investment is. Thus, if a country has an exchange rate that is volatile, the currency could appreciate or depreciate quickly and in turn, affect the total return on the investment. Investors are looking for a safe investment and a steady return from said investment. This data was collected from the IMF from 1995 to 2019. To calculate volatility, I found the standard deviation of the exchange rate given as national currency per SDR, period average. SDR is also known as special drawing rights currency, which includes a basket of currencies: the euro, dollar, yuan, yen, and pound sterling. Monthly exchange rates were collected for the samples, then standard deviation of that series for that year were found. The variable was lagged by one year to better match exchange rate volatility with FDI inflows. The higher the standard deviation, the greater the volatility in the exchange rate. Exchange rate volatility should negatively impact FDI inflows no matter the

sample, and therefore, it is likely that for the full, low, and high-income countries, the exchange rate volatility is likely to be significant and negatively correlated with FDI inflows.

Trade openness will likely have one of the biggest impacts on investors. Various studies argue that a country that is more open in terms of trade, typically attracts higher FDI inflows (Boateng, Hua, Nisar, Wu, 2015). Trade openness is the sum of imports and exports in a country. This was calculated as a share of GDP and is from the UN Accounts Main Aggregates. It should be noted that the variable was lagged by one year. Trade is another indication of economic growth and success. It facilitates cross-country payments and interactions. Typically, the higher openness of trade, the more attractive a country is to an investor. This is largely due to the fact it may indicate a more sustainable country for investors. Trade openness is smaller in larger countries, however, because of the larger domestic markets present. FDI also provides a way for foreign investors to go around trade barriers to access a domestic market. A high-income country usually has more room to be more restrictive in terms of trade openness because of the domestic investment present. The United States, for example, is a wealthy and large country, and thus, can rely more on domestic investment and afford to be less open in terms of trade. It will likely be significant and positively correlated with FDI inflows in all samples, but less significant in the high-income sample for the reasons above.

Tourism, which was collected from the World Bank, is the number of people in thousands to visit a country per year. The tourism industry can be a major area for potential investors. Tourism can help support many businesses and bring in more people to an economy. It is important to many countries around the world and contributes greatly to their GDP. Tourism is its own sector in FDI inflows, further showing how it can be attractive for investors. Tourism, although not as prevalent in every country, likely is significant and positively correlated in some

degree for all samples. The natural log was taken of the total tourism variable to help remedy some of the skewed data. The variable was also lagged by one year.

Finally, inflation was collected from the IMF for 1995 to 2019. To account for the time for inflation to affect FDI, the variable was lagged by one year. Typically, a higher inflation rate is often unattractive to investors. It can display how much cost of living is rising in a country and how much and quickly prices are changing. Currency depreciation thus becomes a concern. This could ultimately affect the overall investment made through FDI, especially if the host country is experiencing higher inflation than most. Therefore, a higher inflation rate, in theory, should have a high significance and a negative correlation with FDI inflows in all samples. It should act as expected.

### Results:

As explained in the previous section, multiple Ordinary Least Squares (OLS) regressions were run to examine the relationship between the main variables of interest and FDI inflows from 1995 to 2019. In total, 12 different regressions were run. All regressions included the same dependent variable and control variables, varying the main variables of interest each time and the sample of countries.

When investors look at a potential investment country, they look at the past few years of data, not just the current year. The investment takes a great deal of time and consideration. Thus, lagging most of the control variables in this study by one year was found beneficial: GDP per capita, population, general government final consumption expenditure, exchange rate volatility, trade openness, mean years of schooling, domestic investment, and inflation. Further, to make

potentially moderately skewed data more normally distributed, the natural log was taken of population, GDP per capita, and tourism.

After running an initial regression with all 98 countries included, the significant relationships found between FDI inflows and the variables of interest (rule of law, government integrity, and control of corruption) and controls were not quite what was expected. These results are seen later in the full sample. This confirmed that different factors affect FDI inflows in different countries. More specifically, what may affect investor's decisions in a high-income country, may not be as different in a low-income country as previously stated. This led to splitting the sample between high- and low-income countries to gain a better understanding about investors. Independent regressions were then run for every variable of interest in both high- and low-income countries.

I tested for multicollinearity and heteroscedasticity. Heteroscedasticity was found to be a problem after running the White's test in the full and high-income samples and thus, robust standard errors were used. The results are shown in Tables 1 through 3.

**Table 1: Impact of Democracy Index and Corruption on FDI Inflows**

Dependent Variable: Foreign Direct Investment Inflows

	Regression 1	Regression 2	Regression 3	Regression
Rule of Law		.540* (.282)		
Control of Corruption			.638** (.307)	
Government Integrity				.020 (.014)
Democracy	1.57*** (.450)	1.36*** (.478)	1.37*** (.482)	1.47*** (.464)
Ln (GDP Per Capita <sub>t-1</sub> )	-.039 (.303)	-.363 (.380)	-.493 (.384)	-.378 (.413)
Ln (	.219 (.240)	.216 (.240)	-.213 (.240)	.212 (.242)
General Government Final Consumption Expenditure <sub>t-1</sub>	-.027 (.052)	-.033 (.052)	-.036 (.051)	-.023 (.052)
Exchange Rate Volatility <sub>t-1</sub>	-.0025*** (.0006)	-.002*** (.0006)	-.002*** (.0006)	-.002*** (.0006)
Trade Openness <sub>t-1</sub>	.062*** (.012)	.062*** (.012)	.062*** (.012)	.062*** (.012)
Mean Years of Schooling <sub>t-1</sub>	.186** (.082)	.181** (.082)	.187** (.082)	.180** (.083)
Domestic Investment <sub>t-1</sub>	.066 (.042)	.064 (.042)	.066 (.042)	.066 (.042)
Inflation <sub>t-1</sub>	-.003** (.001)	-.002* (.001)	-.002* (.001)	-.002* (.004)
Ln (Tourism)	-.341 (.255)	-.317 (.259)	-.284 (.261)	-.298 (.267)
Constant	-2.61 (3.48)	.062 (3.71)	.655 (3.65)	-.994 (3.68)
R-Squared	.1879	.1890	.1895	.1895
F-Stat	5.97***	6.69***	7.33***	7.12***
Observations	1452	1452	1452	1449

Note: Robust standard errors for independent variables are shown in parentheses. Years are controlled for, and the coefficients are reported in Appendix D. The symbols \*, \*\*, \*\*\* correspond to a 10%, 5%, and 1% level of significance

**Table 2: Impact of Democracy Index and Corruption on FDI Inflows: High-Income Countries**

Dependent Variable: Foreign Direct Investment Inflows

	Regression 5	Regression 6	Regression 7	Regression 8
Rule of Law		3.49*** (.856)		
Control of Corruption			2.45*** (.684)	
Government Integrity				.066** (.028)
Democracy	5.54 (4.22)	5.56 (4.18)	6.92* (4.14)	6.76* (4.06)
Ln (GDP Per Capita <sub>t-1</sub> )	.512 (.772)	1.73* (.982)	-1.51 (.980)	-.874 (1.06)
Ln (Population <sub>t-1</sub> )	1.55*** (.491)	1.58*** (.485)	1.57*** (.487)	1.56*** (.486)
General Government Final Consumption Expenditure <sub>t-1</sub>	.163 (.116)	.129 (.113)	.144 (.113)	.151 (.114)
Exchange Rate Volatility <sub>t-1</sub>	-.004 (.032)	-.018 (.030)	-.004 (.029)	-.010 (.031)
Trade Openness <sub>t-1</sub>	.091*** (.091)	.093*** (.018)	.095*** (.018)	.094*** (.019)
Mean Years of Schooling <sub>t-1</sub>	-.563*** (.199)	-.791*** (.205)	-.669*** (.202)	-.634*** (.198)
Domestic Investment <sub>t-1</sub>	-.009 (.134)	-.089 (.136)	-.031 (.133)	-.017 (.133)
Inflation <sub>t-1</sub>	-.895** (.399)	-.799* (.394)	-.645* (.389)	-.732* (.403)
Ln (Tourism)	-.895** (.399)	-.799* (.394)	-.645* (.389)	-.732* (.403)
Constant	-23.58** (9.79)	-3.12 (10.96)	-10.46 (10.06)	-17.43* (10.34)
R-Squared	.2316	.2407	.2392	.2355
F-Stat	5.19***	5.93***	5.69***	5.44***
Observations	717	717	717	716

Note: Robust standard errors for independent variables are shown in parentheses. Years are controlled for, and the coefficients are reported in Appendix E. The symbols \*, \*\*, \*\*\* correspond to a 10%, 5%, and 1% level of significance

**Table 3: Impact of Democracy Index and Corruption on FDI Inflows: Low-Income Countries**

Dependent Variable: Foreign Direct Investment Inflows

	Regression 9	Regression 10	Regression 11	Regression 12
Rule of Law		.407 (.318)		
Control of Corruption			.311 (.358)	
Government Integrity				.006 (.018)
Democracy	.986*** (.314)	.866*** (.327)	.901*** (.323)	.976*** (.319)
Ln (GDP Per Capita <sub>t-1</sub> )	-1.18*** (.241)	-1.22*** (.243)	-1.23*** (.246)	-1.20*** (.245)
Ln (Population <sub>t-1</sub> )	-.833*** (.145)	-.817*** (.146)	-.813*** (.147)	-.831*** (.148)
General Government Final Consumption Expenditure <sub>t-1</sub>	-.073** (.035)	-.073** (.036)	-.077** (.036)	-.077** (.036)
Exchange Rate Volatility <sub>t-1</sub>	-.001* (.0008)	-.001 (.0009)	-.001 (.0009)	-.001* (.0008)
Trade Openness <sub>t-1</sub>	-.003 (.005)	-.004 (.006)	-.003 (.005)	-.003 (.005)
Mean Years of Schooling <sub>t-1</sub>	.532*** (.076)	.546*** (.077)	.544*** (.077)	.538*** (.077)
Domestic Investment <sub>t-1</sub>	.152*** (.022)	.152*** (.022)	.152*** (.022)	.152*** (.022)
Inflation <sub>t-1</sub>	-.001 (.004)	-.001 (.004)	-.001 (.004)	-.001 (.004)
Ln (Tourism)	.302* (.160)	.272* (.161)	.277* (.162)	.300* (.165)
Constant	16.70*** (2.80)	17.35*** (2.85)	17.18*** (2.86)	16.77*** (2.80)
R-Squared	.2322	.2329	.2320	.2333
F-Stat	7.73***	7.56***	7.52***	7.55***
Observations	735	735	735	733

Note: Standard errors for independent variables are shown in parentheses. Years are controlled for, and the coefficients are reported in Appendix F. The symbols \*, \*\*, \*\*\* correspond to a 10%, 5%, and 1% level of significance.



## Variables of Interest

Rule of law, as previously mentioned, deals with willingness of individuals to abide by the rules of society and the confidence they have in such rules. More specifically, the quality of property rights, courts, and law enforcement. In the full sample, rule of law was significant and positively correlated at the 5% level, indicating that for every one-point increase in the rule of law measure, FDI inflows as a share of GDP increased by .540 percentage points. Within the high-income sample, rule of law was significant and positively associated with FDI inflows. This implies that investors are seeking and valuing the protection of property rights and strong law enforcement in high-income countries. However, it was completely insignificant the low-income country sample. In a study done by Biglaiser and Brown (2004), rule of law was found to be insignificant in Latin America, consisting of many low-income countries. From this sample mentioned, there were 13 out of 17 countries in common. Although this is not a large portion of the full sample, it is expected that most low-income countries will act similar to those mentioned in the study. Latin America is very different in terms of rule of law and typically much weaker. Out of the 63 low-income countries in the sample, slightly less than 30% are Latin American. Thus, Latin America is being overrepresented in this sample. It would make sense that low-income countries did not display significance with rule of law. Another possible explanation for these results is the difficulty most low-income countries have ensuring the protection of property rights and law enforcement, especially if they are a more corrupt country. The summary stats seen in Appendix B and C show that on average, the score is significantly lower for the low-income country sample compared to that of the high-income country sample. The mean for low-income countries was a rule of law score -.47, while the mean in high-income countries was a score 1.31.

The next variable of interest is control of corruption. Control of corruption was significant and positively correlated at the 5% level in the full sample, significant and positively correlated at the 1% level in the high-income country sample, and not significant at all in the low-income country sample. In the same study done by Biglaiser and Brown (2004), similar results occurred. A possible explanation for the lack of significance in low-income countries is the time horizon with foreign direct investment. Investors need to see consistent change in a country in terms of political stability, which includes control of corruption, before the country's reputation begins to change (Biglaiser and Brown, 2004). Basically, if a country is corrupt, that will take years to remedy, and it won't happen overnight. This is a very similar philosophy to rule of law and government integrity. This is because they are very highly correlated.

Multicollinearity between the three variables was tested and found. It can be seen in the summary stats that in the high-income country sample, the mean control of corruption score was 1.40, significantly higher than the low-income mean score of -.52. The minimum score for low-income countries was also significantly lower at -1.64. High-income countries have a minimum score of -.58, which on a -2.5 to 2.5 scale, is a large difference. These results were not consistent with a study done by Kim (2010), however. In this study, it was concluded that a host country with a higher level of corruption and a lower level of democracy would attract foreign direct investment. In this study, control of corruption was positively significant, indicating that for every one-point increase in control of corruption, FDI inflows as a share of GDP increased 2.45 percentage points in the high-income country sample. Another possible explanation for the control of corruption results in low-income countries is again, the overrepresentation of Latin America. Latin American countries are typically much more corrupt and likely have a large impact on the sample results. For example, the mean control of corruption was a score of -.52. In

2009, Ecuador had a score of -.80 and Honduras had a score of -.90. Not all low-income countries are the same in terms of corruption, which is obvious in Latin America.

The third variable of interest used in this study was government integrity. Again, similar results occurred. Government integrity was not significant at all in the full and low-income countries samples but was significant at the 5% level in the high-income country sample. Thus, in the high-income country sample, if government integrity score increased by one point, FDI inflows as a share of GDP increased by .066 percentage points. The scale for government integrity is 0-100, 100 being absolute government integrity. Thus, an increase in score is positive. Looking further at the statistics for government integrity, the mean government integrity score for high-income countries was 71.63, with a standard deviation of 17.84. On the other hand, in the low-income country sample, the mean government integrity score was only 31.91, with a standard deviation of 11.62 and a minimum score of 4. However, there were some outliers in the group since the maximum score was 70, which could skew the data. Ghana was a country that proved to have a high government integrity for a few years. It is also possible that for similar reasons corruption and rule of law were not significant in low-income countries, government integrity is not significant either. Investors looking to invest in a high-income country are seeking a government with high integrity to again, protect their investments and ensure the government will follow through on commitments made.

Democracy, the final variable of interest, was significant at the 1% level in both the full sample and the low-income country sample. Surprisingly, however, it was almost entirely insignificant in the high-income country sample. It displayed significance at the 10% level in regressions 6 and 7 of the high-income country sample. Democracy led to another surprising result. In the full sample, if the country was determined democratic, FDI inflows on average

increased by 1.37 percentage points as a share of GDP in terms of regression 3 relative to the less democratic group. This was about average for all four regressions in the full sample. In terms of the low-income country sample, if democracy was present, FDI inflows on average increased by .901 percentage points as a share of GDP in terms of regression 11 relative to the less democratic group. This result was also stable among the four regressions. While the high-income country sample was also positively correlated, it was much less significant. The Polity2 score, was also used as a factor of democracy in a study by Biglaiser and Brown (2004). It was determined in this study, however, that regime type, such as democracy was not an important factor for investors. While that was the case for high-income countries, investors appeared to prefer the higher level of democracy in low-income countries. One possible explanation for this is the protection and stability that comes with democracies. Lower-income countries have a harder time guaranteeing these rights without a democratic government. Thus, making it a much more important factor to investors looking at low-income countries.

## **Controls**

As previously stated, GDP per capita was both lagged and taken in form of the natural log. This was to attempt to diminish the high variation in data and to account for the fact FDI inflow decisions are made based on past observations. GDP per capita was insignificant in both the full sample and the high-income country sample, but significant at the 1% level in the low-income country sample. Therefore, in respect to the low-income country sample, if GDP per capita increased by 1%, FDI inflows as a share of GDP decreased by .0118 percentage points in regression 9. There was little variance between regressions 9 and 12 in the low-income country sample in terms of the natural log of GDP per capita lagged. This negative correlation indicates that a higher GDP per capita attracts less FDI inflows in low-income countries. Since a higher

GDP per capita means higher incomes, and thus higher wages, it is possible that investors are wanting to pay less for work in the host country. It is also possible that there is a potential ideal GDP per capita for investors in low-income countries: one that is neither too high to increase wages, but high enough to show a steady economy.

The lagged population was not significant in the full sample, which was surprising since it was significant at the 1% level both in the high- and low-income countries samples.

Interestingly enough, population was positively correlated with FDI inflows in high-income countries, but negatively correlated in low-income countries. This indicated that in the high-income country sample, if the lagged population increase by 1%, FDI inflows as a share of GDP would increase by .0158 percentage points in regression 5. Again, there was little variance among the four regressions. On the other hand, in the low-income country sample, if the lagged population increased by 1%, FDI inflows as a share of GDP would decrease by .00817 percentage points in regression 9. This is a much different result than hypothesized, and it is likely that there were some low-income countries that were affecting this result, making it negatively correlated with FDI inflows. Low-income countries like China, India, and Indonesia all have a larger GDP than the average low-income country. As previously stated, it is proposed that in 2023 China will become a high-income country. For these countries, FDI is just a small portion of their economy. As seen in the summary stats, the mean population is higher in low-income countries than high-income countries. The mean FDI inflows is 3.64%, which is higher than the FDI inflows in China, India, Indonesia, etc. These countries are likely skewing the data. This further proves FDI does not support their economies as much, which could possibly explain the surprising results. It would be interesting to see how the results would change if the low-income countries with a higher GDP were dropped.

Another surprising result was lagged general government final consumption expenditure being significant at the 5% level in the low-income country sample, but insignificant in the full and high-income countries samples. If general government final consumption expenditure as a share of GDP increases by 1 percentage point, FDI inflows as a share of GDP decrease by .077 percentage points in regressions 10 and 11. This indicates that the larger the government role in the low-income economy, the less attractive the country will be to potential investors. This was, for the most part, in line with the hypothesis formed.

Both lagged exchange rate volatility and lagged trade openness were significant at the 1% level in the full sample. On the contrary, only trade openness was significant at the 1% level in the high-income country sample, and neither were significant in the low-income country sample except for exchange rate volatility which was significant at the 5% level in regressions 11 and 12. The trade openness result was an expected result based on previous literature. Typically, a more liberal trade regime facilitates FDI inflows (Boateng, Hua, Nisar, Wu, 2015). Based on a study done by Boateng, Hua, Nisar, and Wu (2015), exchange rates effect FDI inflows in two different ways: the wealth effect channel and the relative production cost channel. If the exchange rate is volatile in the host country, means labor costs could potentially decrease, raising profits for investors. In terms of the wealth effect, foreign investors will gain more wealth than their domestic competition if the currency depreciates during volatility. A volatile exchange rate for investors could also potentially provide more buying power, thus eliminating domestic competition. While investors want exchange rates to weigh in their favor, having a high volatility provides more risk which can affect an investor greatly. Thus, it follows that exchange rate volatility would be negatively correlated with foreign direct investment. In this case, for every 1-

point increase in the standard deviation of exchange rate volatility, FDI inflows decreased by .002 percentage of GDP in the full sample.

Lagged mean years of schooling was significant at the 1% level in both the high- and low- income country samples, and 5% level in the full sample. However, while in full and low-income country samples were both positively correlated, the high-income country sample was found to be negatively correlated. Meaning for every 1-year increase in schooling, FDI inflows as a share of GDP decreased by about .791 percentage points in regression 5. Although this is surprising, there may be a few possible explanations for this negative coefficient. According to Ho and Rashid (2011), this relationship could largely be since labor costs increase as skills are improved. The high-income country sample is based on high-income countries, which will have a more educated population in general, leading to higher costs of labor. On the other hand, there are some investors seeking a higher knowledge level. This signifies that the more years of school a country has, the more attractive it can be. This could be true for both high and low-income countries. It is possible that there is an ideal number of years of schooling for investors when they are looking at potential high and low-income countries.

Although lagged domestic investment was insignificant in the full and high-income countries samples, it was significant at the 1% level in the low-income country sample. Based on the results in the full sample, lagged domestic investment had a positive correlation with FDI inflows. As domestic investment as a share of GDP increased by 1 percentage point, FDI inflows as a share of GDP increased by .152 percentage points in all four regressions of the low-income sample. One possible explanation for this positive correlation is the potential inclination that this gives to investors. A higher domestic investment will indicate that returns on investment in the

host country are good. This can promote both foreign and domestic investment in the host country.

In both full and high-income country samples, lagged inflation was significant at the 10% level. It should be noted that in regression 8 of the high-income country sample, it was significant at the 5% level. So, as inflation increases by 1 percentage point, FDI inflows as a share of GDP decrease by .002 percentage points in the full sample. This result is consistent with that found in various other pieces of literature. Ho and Rashid (2011), said that while there may be mixed results, generally a low inflation rate will lead to a rise in FDI inflows. As inflation rises, the benefits of investing decrease significantly. Rising inflation diminishes purchasing power of consumers in the host country. Boateng, Hua, Nisar, and Wu (2015), found similar results, claiming inflation relates to economic stability. Lagged tourism had very similar results as inflation in terms of high-income country sample, but it was insignificant in the full sample and significant at the 10% level in the low-income country sample. The low-income country shows that as tourist arrival increases by 1 percent, FDI inflows as a share of GDP increase by .00272 percentage points. The same study previously mentioned done by Ho and Rashid (2011), found similar results regarding tourism. It was said that a positive increase in tourism would likely facilitate and attract investors. However, unlike the study, tourism was negatively correlated with FDI inflows in the high-income country sample. This result is surprising. A couple possible explanations for this negative correlation could be the fact tourism is a main source of revenue in some low-income countries. However, in high-income countries, there are many factors of revenue, and therefore, it would make up only a small portion of their economy.



The results of this study were very similar to those seen in other forms of literature. However, it expanded in certain areas, including controls and dummies, allowing a more complete picture to be seen in terms of political effects on FDI inflows.

Conclusion:

In conclusion, it ultimately is dependent on the selected sample to determine if political determinants are significant or not. After splitting the sample between high and low-income countries, it was concluded that control of corruption, rule of law, and government integrity were significant and positively correlated in high-income countries but insignificant in low-income countries. The opposite was true for democracy. While it was significant and positively correlated at the 1% level in low-income countries, it was almost entirely insignificant in high-income countries.

These results agree with some region-specific literature, indicating reliable results for both high- and low-income countries, respectively. It would be beneficial to look at different political determinants with a similar sample in the future. There is not much literature on this area, let alone with such a broad sample. This research could be highly beneficial in determining why investors behave the way they do when it comes to FDI. It also could be interesting to see how the COVID-19 pandemic shapes foreign direct investment in future years. There is much change currently happening in the world and many unknowns. More research is encouraged in this area to gain a better understanding of foreign direct investments and how it is affected by political determinants.

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Appendix A: Description and Source of Variables

	Description	Source
FDI Inflows	The net inflows of investment to acquire a lasting interest in an economy other than that of the investor. This is shown as a share of GDP.	World Development Indicators
Rule of Law	Rule of law represents the extent to which citizens have confidence in and abide by the rules of society. Shown on a scale of -2.5 to 2.5, 2.5 being a strong government.	Worldwide Governance Indicators
Control of Corruption	Measures the extent to which public power is exercised for private gain. Shown on a scale of -2.5 to 2.5, 2.5 being a strong government.	Worldwide Governance Indicators
Government Integrity	Represents the wiliness the government has to fulfill its obligations it has to the public. Shown on a scale of 0 to 100, 100 being high integrity.	Heritage Foundation
GDP Per Capita	Measures a country's economic output per person. Shown as a percentage of GDP.	U.N. Accounts Main Aggregates
Population	Represents the total number of people in a country. Shown as the total amount.	U.N. Stats
General Government Final Consumption Expenditure	Represents all current government expenditure incurred by government in its production of non-market final goods and services. Shown as a percentage of GDP.	U.N. Accounts Main Aggregates
Exchange Rate Volatility	The risk of unexpected movements in an exchange rate. Monthly exchange rates were collected for the samples, then standard deviation of that series for that year were found.	International Monetary Fund

Trade Openness	The sum of the exports plus the imports in a country. Shown as a percentage of GDP.	U.N. Accounts Main Aggregates
Mean Years of Schooling	Average number of years of education received by people ages 25 and older. Shown in years.	United Nations Development Program Human Development Reports
Domestic Investment	Investment in companies and enterprises in one's own country. Shown as a percentage of GDP.	U.N. Accounts Main Aggregates
Inflation	Represents a general increase in prices and fall in the purchasing value of money. Shown in percentages.	International Monetary Fund
Tourism	The number of people entering a country per year for recreational purposes. Shown in thousands of people.	World Development Indicators
Democracy	Based on the polity2 score. This score captures a regime authority spectrum on a 21-point scale ranging from -10 (hereditary monarchy) to +10 (consolidated democracy). Anything greater than 6 was considered a democratic state for the purposes of this study.	The Polity Project

Appendix B: Full Sample Summary Results

	Mean	Standard Deviation	Minimum	Maximum
FDI Inflows	4.46	7.56	-58.32	86.59
Rule of Law	.18	1.03	-2.32	2.13
Control of Corruption	.18	1.10	-1.64	2.47
Government Integrity	46.61	23.89	4	100
GDP Per Capita	15738.03	19902.55	233.42	106582.3
Population	6090000 0	184000000	267629	14300000000
General Government Final Consumption Expenditure	16.22	5.52	.76	38.51
Exchange Rate Volatility	1290000 0	633000000	0	31100000000
Trade Openness	80.15	56.45	15.78	412.12
Mean Years of Schooling	8.72	2.90	1.5	14.2
Domestic Investment	22.52	7.04	2.77	76.33
Inflation	6.43	28.01	-6.81	1058.37
Tourism	1460000 0	29700000	9000	212000000
Democracy	.72	.45	0	1



Appendix C: High-Income Sample Summary Results

	Mean	Standard Deviation	Minimum	Maximum
FDI Inflows	5.87	10.88	-58.32	86.59
Rule of Law	1.31	.56	-.63	2.13
Control of Corruption	1.40	.70	-.58	2.47
Government Integrity	71.63	17.84	27	100
GDP Per Capita	35746.75	20000.51	4872.9	106582.3
Population	27900000	53600000	267629	329000000
General Government Final Consumption Expenditure	19.28	4.56	7.57	34.52
Exchange Rate Volatility	2.08	7.86	0	106.98
Trade Openness	98.75	78.47	17.45	412.12
Mean Years of Schooling	11.09	1.58	6.4	14.2
Domestic Investment	21.72	3.84	10.2	46.65
Inflation	2.58	2.99	-4.48	28.31
Tourism	26300000	39000000	211000	212000000
Democracy	.941	.24	0	1

Appendix D: Low-Income Sample Summary Results

	Mean	Standard Deviation	Minimum	Maximum
FDI Inflows	3.64	4.45	-37.15	55.07
Rule of Law	-.47	.56	-2.32	1.08
Control of Corruption	-.52	.52	-1.64	1.22
Government Integrity	31.91	11.62	4	70
GDP Per Capita	3732.79	3072.46	233.42	15375.76
Population	80700000	226000000	1128575	1430000000
General Government Final Consumption Expenditure	14.21	5.17	.76	38.51
Exchange Rate Volatility	20400000	796000000	0	31100000000
Trade Openness	69.17	33.31	15.78	225.27
Mean Years of Schooling	7.32	2.57	1.5	13.1
Domestic Investment	22.99	8.36	2.77	76.33
Inflation	9.94	38.33	-6.81	1058.37
Tourism	7718205	19600000	9000	163000000
Democracy	.58	.49	0	1

Appendix E Table 1: Impact of Democracy Index and Corruption on FDI Inflows Years Full Sample

	Regression 1	Regression 2	Regression 3	Regression 4
Year 3	.190 (.525)	.208 (.532)	.196 (.529)	.187 (.534)
Year 4	.912 (.572)	.910 (.571)	.880 (.565)	.856 (.567)
Year 5	2.42 (1.36)*	2.47 (1.37)*	2.43 (1.37)*	2.39 (1.36)*
Year 6	3.09 (1.15)***	3.15 (1.15)***	3.10 (1.15)***	3.07 (1.15)***
Year 7	1.15 (.996)	1.22 (1.00)	1.20 (.997)	1.14 (1.00)
Year 8	-.078 (.649)	.011 (.664)	.031 (.662)	-.062 (.664)
Year 9	-.477 (.591)	-.403 (.610)	-.401 (.607)	-.474 (.611)
Year 10	-.097 (.751)	.009 (.770)	.015 (.765)	-1.90 (.765)
Year 11	1.60 (1.06)	1.72 (1.07)	1.74 (1.07)	1.82 (1.06)*
Year 12	3.61 (1.58)**	3.75 (1.59)**	3.75 (1.56)**	3.64 (1.59)**
Year 13	3.35 (2.01)*	3.52 (2.02)*	3.52 (2.02)*	3.39 (2.01)*
Year 14	1.74 (.994)*	1.90 (1.02)*	1.91 (1.01)*	1.76 (1.01)*
Year 15	-.206 (.812)	-.042 (.834)	-.011 (.837)	-.176 (.832)
Year 16	.762 (1.07)	.916 (1.08)	.948 (1.08)	.791 (1.07)
Year 17	.889 (.927)	1.04 (.946)	1.06 (.944)	.919 (.940)
Year 18	.338 (.778)	.545 (.797)	.562 (.800)	.419 (.794)
Year 19	-.708 (.804)	-.542 (.827)	-.518 (.831)	-.657 (.827)
Year 20	-.459 (.690)	-.334 (.709)	-.267 (.721)	-.407 (.715)
Year 21	.275 (1.11)	.403 (1.13)	.448 (1.12)	.273 (1.11)
Year 22	.267 (1.06)	.405 (1.07)	.441 (1.06)	.256 (1.06)

Year 23	-1.58 (.914)**	-1.44 (.922)	-1.39 (.930)	-1.58 (.909)*
Year 24	-3.90 (1.20)***	-3.73 (1.21)***	-3.69 (1.21)***	-3.88 (1.20)***
Year 25	-2.25 (1.03)**	-2.00 (1.06)*	-1.97 (1.05)*	-2.19 (1.04)**

Note: Robust standard errors for independent variables are shown in parentheses. The symbols \*, \*\*, \*\*\* correspond to a 10%, 5%, and 1% level of significance

Appendix F Table 2: Impact of Democracy Index and Corruption on FDI Inflows Years High-Income Countries

	Regression 5	Regression 6	Regression 7	Regression 8
Year 3	.532 (.603)	.537 (.621)	.439 (.607)	.874 (.671)*
Year 4	2.11 (.702)***	2.17 (.659)***	1.92 (.647)***	2.29 (.690)***
Year 5	4.38 (1.78)**	4.60 (1.79)**	4.25 (1.78)**	4.54 (1.79)**
Year 6	5.67 (1.47)***	6.00 (1.45)***	5.58 (1.45)***	5.92 (1.46)***
Year 7	2.65 (1.28)**	3.07 (1.30)**	2.71 (1.27)**	2.92 (1.31)**
Year 8	1.58 (.856)*	2.06 (.886)**	1.77 (.872)**	1.91 (.902)**
Year 9	1.12 (.780)	1.51 (.827)*	1.23 (.803)	1.46 (.856)*
Year 10	1.21 (1.05)	1.89 (1.08)*	1.51 (1.03)	1.55 (1.07)
Year 11	4.81 (1.63)***	5.68 (1.62)***	5.25 (1.59)***	5.16 (1.64)
Year 12	7.32 (2.50)***	8.21 (2.52)***	7.72 (4.19)*	7.69 (2.51)***
Year 13	6.98 (4.22)*	7.82 (4.22)*	4.37 (1.84)**	7.29 (4.21)*
Year 14	3.97 (1.83)**	4.84 (1.86)**	2.00 (1.38)	4.24 (1.85)**
Year 15	1.50 (1.35)	2.49 (1.41)*	4.01 (2.02)**	1.83 (1.39)
Year 16	3.71 (2.02)*	4.35 (2.03)**	3.11 (1.48)**	4.01 (2.03)**
Year 17	2.82 (1.49)*	3.43 (1.50)**	3.01 (1.41)**	3.13 (1.51)**
Year 18	3.13 (1.41)*	3.85 (1.42)***	3.46 (1.41)**	3.49 (.671)**
Year 19	1.20 (1.55)	2.00 (1.57)	1.61 (1.57)**	1.57 (1.44)
Year 20	2.16 (1.29)*	2.73 (1.30)**	2.64 (1.29)**	2.56 (1.59)*
Year 21	3.49 (2.46)	4.23 (2.49)*	3.94 (2.48)	3.94 (1.33)

Year 22	4.96 (1.93)**	5.95 (1.95)***	5.43 (1.94)***	5.40 (1.99)***
Year 23	-.135 (2.07)	.934 (2.06)	.454 (2.07)	.394 (2.06)
Year 24	-5.15 (2.84)*	-3.95 (2.91)	-4.49 (2.90)	-4.57 (2.89)
Year 25	-.448 (2.39)	.794 (2.38)	.182 (2.40)	-.082 (2.41)

Note: Robust standard errors for independent variables are shown in parentheses. The symbols \*, \*\*, \*\*\* correspond to a 10%, 5%, and 1% level of significance

Appendix G Table 3: Impact of Democracy Index and Corruption on FDI Inflows Years Low-Income Countries

	Regression 9	Regression 10	Regression 11	Regression 12
Year 3	.481 (1.70)	.504 (1.70)	.501 (1.70)	.442 (1.70)
Year 4	-.221 (1.72)	-.225 (1.72)	-.245 (1.72)	-.231 (1.72)
Year 5	.085 (1.72)	.096 (1.72)	.094 (1.72)	.052 (1.71)
Year 6	-.126 (1.71)	-1.06 (1.71)	-.087 (1.71)	-.166 (1.71)
Year 7	.318 (1.71)	.356 (1.71)	.364 (1.71)	.269 (1.71)
Year 8	-.873 (1.57)	-.821 (1.57)	-.853 (1.57)	-.919 (1.57)
Year 9	-.596 (1.55)	-.572 (1.56)	-.580 (1.53)	-.653 (1.56)
Year 10	.433 (1.52)	.471 (1.52)	.475 (1.52)	-.048 (1.54)
Year 11	-.050 (1.50)	-.001 (1.51)	.000 (1.50)	.196 (1.51)
Year 12	1.44 (1.50)	1.49 (1.51)	1.51 (1.51)	1.40 (1.50)
Year 13	1.64 (1.42)	1.72 (1.42)	1.76 (1.42)	1.60 (1.42)
Year 14	1.48 (1.41)	1.56 (1.42)	1.59 (1.42)	1.44 (1.41)
Year 15	-.582 (1.41)	-.497 (1.41)	-.489 (1.41)	-.620 (1.40)
Year 16	-.530 (1.40)	-.446 (1.41)	-.445 (1.40)	-.577 (1.40)
Year 17	.370 (1.39)	.448 (1.39)	.462 (1.39)	.323 (1.39)
Year 18	-.704 (1.36)	-.623 (1.38)	-.605 (1.37)	-.749 (1.36)
Year 19	-1.20 (1.37)	-1.12 (1.37)	-1.11 (1.37)	-1.24 (1.37)
Year 20	-1.34 (1.37)	-1.27 (1.37)	-1.28 (1.37)	-1.38 (1.37)
Year 21	-1.03 (1.37)	-.970 (1.37)	-.983 (1.37)	-1.10 (1.37)
Year 22	-2.06 (1.37)	-2.01 (1.37)	-2.03 (1.37)	-2.14 (1.38)

Year 23	-1.79 (1.37)	-1.73 (1.37)	-1.75 (1.37)	-1.87 (1.38)
Year 24	-2.12 (1.38)	-2.06 (1.38)	-2.07 (1.38)	-2.20 (1.39)
Year 25	-2.42 (1.39)*	-2.33 (1.39)*	-2.31 (1.39)*	-2.48 (1.39)*

Note: Standard errors for independent variables are shown in parentheses. The symbols \*, \*\*, \*\*\* correspond to a 10%, 5%, and 1% level of significance