Three Essays on Foreign Direct Investment (FDI)

Thesis submitted for the degree of

Doctor of Philosophy

at the University of Leicester

by

Saima Kamran Pathan

School of Management

University of Leicester

November 2013

To,

Kamran, Maryam, Abdullah, Azlan

Mohammad Afzal Qureshi, Hamida Qureshi

Three Essays on Foreign Direct Investment (FDI)

Saima Kamran Pathan

Abstract

This thesis examines the effects of joining currency unions and trade agreements as well as political risk on FDI. It also engages in the empirical examination of the Eclectic Paradigm. The aim of this research is to extend the current knowledge on the determinants of FDI, as various empirical studies have found mixed results. The first empirical chapter investigates the impact of membership of currency unions and trade agreements on FDI inflows, outflows, and net FDI (inflows-outflows) by using pooled OLS estimation method for a sample of 180 countries during the period of 1970 to 2007. The second empirical chapter analyses the impact of political risk on FDI inflows into OECD countries by using pooled OLS estimation and fixed effects panel data methods throughout the period of 1975 to 2009. The third empirical chapter examines the relationship between determinants of FDI from the perspective of Eclectic Paradigm for the sample of 196 countries for the period of 1970 to 2009. My study uses up-to-date large macro datasets for long periods. Insights are provided on the impact of regional trade agreements and currency unions on FDI, a topic on which the literature is relatively scarce. Similarly, another contribution is the analysis of FDI outflows and net FDI, which did not receive much attention in previous studies. This thesis further investigates the impact of political environment in the country on FDI inflows using a wide range of political indicators. Lastly, the investigation presented here confirms the predictions of the Eclectic

Paradigm, as ownership, location and internalization-specific advantages seem to play an important role in the investment decisions of MNE. Finally, some implications for investors and governments as well as suggestions for further studies are presented at the end of the thesis.

Acknowledgements

First of all, I would like to present my sincere thanks to Almighty God for giving me this opportunity, strength and courage and helped me in every way in completing this thesis.

I gratefully acknowledge my supervisor, Dr. Tomasz Piotr Wisniewski for his overall help, valuable guidance and discussions throughout my research work. I am also indebted to my supervisor, Dr. Meryem Duygun Fethi for her overall help and guidance, especially emotional support during difficult times. Without the help of both of my supervisors this work would have never been possible for me to complete.

I acknowledge my Employer, University of Sindh for awarding me the scholarship to complete my doctoral degree.

School of Management at University of Leicester provided a very good atmosphere and working environment. Jo Brewis and Teresa Bowdrey are of great help to the PhD community.

I would also like to thank: my husband Kamran Taj Pathan, who stood with me in every part of the research work and family life as a friend, my children Maryam, Abdullah and Azlan and my parents Muhammad Afzal Qureshi and Hamida Qureshi for making me able to set higher goals and to follow my dreams in my life. They gave my thoughts the wings to fly.

Thank you!
Saima Kamran Pathan

Table of Contents

List of Tables

List of Figures

List of Abbreviations

BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest
BEAC	Banque Centrale des Etats de l'Afrique Centrale
BoP	Balance of Payment
CACM	The Central American Common Market
CAN	Andean Community (Comunidad Andina in Spanish)
Caricom	Caribbean Community and Common Market
CARIFTA	Caribbean Free Trade Association
CEMAC	Economic and Monetary Community of Central Africa
CIS	Commonwealth of Independent States
CUs	Currency Unions
EAC	East African Community
EAEC	Eurasian Economic Community
ECCA	East Caribbean Currency Area
EMU	European Monetary Union/ European Economic and Monetary Union
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GNP	Gross National Product

IDP	Investment Development Path
MERCOSUR	Southern Common Market
MNEs	Multinational Enterprises
OECD	the Organisation for Economic Co-operation and Development
OFDI	Outward Foreign Direct Investment
OLI	Ownership, Location, and Internalization
OLS	Ordinary Least Squares
PLC	Product life cycle
RAs	Regional Agreements
RIAs	Regional Integration Agreements
RTAs	Regional Trade Agreements
SACU	Southern African Customs Union
TNCs	Transnational Corporations
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States
USSR	Union of Soviet Socialist Republics
WAEMU	West African Economic and Monetary Union
WDI	World Development Indicators
WTO	World Trade Organization

Chapter 1
Introduction

This chapter covers the scope and background of the study by describing the research objectives, motivations, selection of methodology, contribution and outline of the thesis. The motivation section gives an overview of the area of research and the rationale for the selection of the subject of this research. The research objectives section describes the exact research questions to be analysed in this thesis. The last section explains the reasons behind the selection of methods used in this study.

1.1 Background and Motivation

FDI is a vital element of international business activities taking place all over the world. For many years FDIs have been considered unfavourable for the growth of economies and domestic investments of developing countries. However, the views on the matter have evolved since. Traditionally, FDIs were observed to be moving from developing to developed countries. This trend has changed and an increase in FDIs to developing countries was observed, mostly due to market seeking motive of MNEs.

The data on FDI inflows (UNCTAD 2013) show that developed countries had largest share of FDI inflows across the globe until 1982. But a marked changed has occurred in the share of FDI inflows to developing countries exceeded the inflows to developed countries from 1983 to date. The nature of FDI changes for the classification of developing and developed countries. The movement of FDI inflows between developed countries usually show that FDI substitute trade. On the other hand, the transfer of inflows from developed countries to developing countries is usually trade creating (Ghose 2004). The reason for increase in FDI inflows to developing countries might be that a considerable number of developing countries have significantly decreased constraints on capital inflows such as restrictions on capital repatriation and others have offered subsidies or tax privileges to foreign investors (Ghose 2004). Another reason is MNEs invest in developing countries due to market-seeking and resource-seeking motive. Further, major investments from developed countries (e.g. Japan) increased into developing countries during 1980s (UNCTAD 1991). Recently, there was an increase of FDI inflows from developing countries to Africa (UNCTAD 2013).

Academic researchers have tried to examine the role of FDI inflows in the economic development of a country for a long time. FDIs are generating considerable interest in terms of increasing share in privatization as well as technology and knowledge transfer through joint ventures (Haddad and Harrison 1993). FDI is considered to have positive effects on host countries in terms of increase in financial resources, employment, production and

consumption (Alfaro et al. 2004; Chowdhury and Mavrotas 2006; Moghaddam and Redzuan 2012). Due to the potential benefits of FDI, a great number of modifications were observed worldwide in the policymakers' approaches towards taxation and liberalization of international business (Carkovic and Levine 2005). FDI has received much attention over the last three decades. Foreign direct investment has increased dramatically over the past few decades. Although global FDI dropped significantly during the crisis of 2008-09, the period that followed witnessed a robust rebound.

In this thesis, I empirically test three macroeconomic FDI hypothesises, namely: (1) The effects of currency unions and trade agreements on Foreign Direct Investment (2) Political Risk Hypothesis and (3) Eclectic Paradigm. I attempt to investigate the validity of above-mentioned FDI theories by identifying the main economic, institutional and political variables affecting the important decisions of multinational enterprises. Through this examination I will try to find out whether these theories are able to successfully explain the underlying economic processes. The ups and downs of international investments have led to extensive research on FDI. In spite of the substantial amount of research which was undertaken, the empirical work on the determinants of FDI is still inconclusive (Moosa 2009) and most of the current studies are limited to a particular country or region. Further, the changes observed in the past decades, such as technological innovations, economic, political and financial integration, rising interest in global competitiveness, varying trade and

investment policies, intensifying research and development are all likely to have considerable influence on the world economy. The consequence of which might cause many theories to become obsolete. Therefore, there is a growing need to test the theories of FDI to observe the effects of these emerging phenomena on investments around the world.

Also the effects of membership of different currency unions and trade agreements differently affects host countries as the change in currency, benefit of large market and government subsidies to members influence the businesses. This thesis examines these areas to offer substantial contribution in terms of knowledge to policy makers and investors for future decisions.

The risk associated with political factors has a great impact on the decision of selection of location of international investors as political uncertainty has huge impact on investments. This study has particularly selected the variables related with political parties in host countries to examine the impact on FDI flows.

Among different theories of FDI, Eclectic paradigm is one of the wide-ranging framework which covers various aspects of ownership, location and internalization factors affecting FDI behaviour of international investors (Dunning 1981a, 1998; Narula 1996; Narula and Dunning 2000). Eclectic paradigm is believed to be a complete analytical framework for empirical studies in the field of international business (Tahir and Larimop 2004).

My thesis analyses big macroeconomic datasets with maximum number of countries for a large span of time. The data is also more recent

compared to some of the papers published in the past, which enables me to verify whether the earlier conclusions still hold. I also integrate a variety of variables that cover various regional, political and macroeconomic aspects. My study also looks at FDI outflows and net FDI, and only limited literature is available regarding these issues. Scholars still debate about the relative importance of different factors (e.g. which of the pillars of OLI is most important) and I intend to contribute to this debate. All of these hypotheses are of great importance, considering the enormous amounts of money at stake, which corresponds to the large FDI flows.

1.2 Research Aims and Objectives

The purpose of this thesis is to provide further investigation and extend the current knowledge on the determinants of FDI by keeping in view the changing international conditions in economics, international business and technology, which bring great changes in the operations and methods of almost every process involved in businesses. Our current knowledge of FDI is largely based on very limited data. The aim of this research is therefore to take a new look at increasing membership of international organizations, currency unions, political issues, legal tradition of countries and to examine their impact on FDI using a large dataset. This study also sheds new light on Eclectic Paradigm from the perspective of its three pillars: ownership, location and internalization.

1.2.1 Research Questions

The following are the main research questions contained in the thesis:

1. What impact do customs unions and currency unions have on the FDIs of member countries?
2. Does the host country political risk affect the FDI inflows?
3. Does the Eclectic Theory describe the changing patterns and trends in international investment from the FDI perspective?

1.3 Overview of Methods

The selection of methods is very important for any quantitative study. In this section we firstly detail the nature of the compiled datasets and explain the methodological approach adopted. FDI data is derived from World Development Indicators, World Bank. I opted for a large sample size because it will be more appropriate to generalize the findings and suggest policy implications for countries.

In the first essay, I analyse inward, outward and net (net inflows – net outflows) foreign direct investment as a percentage of Gross Domestic Product (GDP). I focus on the panel data on 180 countries over the period of 1970 to 2007. I estimate a pooled Ordinary Least Squares (OLS) model using dummy variables for currency unions and trade agreements. Various reliable international sources have been used for the collection of data for these theories. The first study uses pooled OLS method to investigate the impact of currency unions and trade agreements. This approach is superior to fixed

effect panel methodology, as it avoids the problem of perfect multicollinearity between currency unions/ trade agreements dummy variables and the fixed effects.

In the second and third empirical chapter, I used pooled OLS estimation and fixed effects methods for panel data to investigate the effects of political risk and the variables of Eclectic Paradigm. Fixed effects methods control for time invariant heterogeneity across countries and they are relatively robust to omitted variable bias. Additionally, some robustness checks have documented that this is indeed the correct methodology to use in this context. The pooled Ordinary Least Squares models effectively help in assessing the robustness of results.

1.4 Thesis Contributions

My study focuses on relevant and up to date macro data sets, which cover recent data, larger number of countries, a longer time period and incorporate more variables compared to other studies. My sample is more comprehensive and includes developed, developing and transition economies. Earlier research used small sample of countries and limited number of variables. This thesis highlights the important role of the membership in regional trade agreements and currency union and conducts an investigation into outward FDI and net FDI, as not many studies have analysed this issue. Another important contribution is the analysis of the impact of political risk on FDI from the perspectives of ruling parties and leaders holding executive

power. Large set of political factors are considered here and some new and valuable insights are gained.

The current study can contribute to our understanding of the role that economic and regional factors play in the competitiveness of countries. This research can help scholars and policymakers in their analyses of the effects of economic integration and economic factors on international investment decisions. It can also contribute to the increased comprehension of the theories of FDI and provide guidelines for future research work.

1.5 Thesis Outline

This thesis is organized in seven chapters. Chapter 1 presents background of the study, research aims and objectives, overview of the methods and thesis contribution. Chapter 2 reviews the FDI literature. Chapters 3 consists of methodology, Chapter 4, 5 and 6 consist of empirical essays on the effects of currency unions and trade agreements, political risk on FDI and a study on Eclectic Paradigm. Each of these quantitative chapters analyse different datasets with their individual methodology, data and results interpreted from different perspectives.

The second chapter gives a brief overview of the existing literature by discussing the definitions of FDI, the different ways in which FDI takes place and forms of FDI. FDI theories explain why firms undertake investments abroad and provide rationale for the important country-specific

macroeconomic factors which contribute towards the increase or decrease in foreign investments.

In the third chapter methodological issues are discussed.

In the fourth chapter, different currency unions and trade agreements are discussed. An empirical examination is conducted to analyse what is the impact of the membership of currency unions and trade agreements on FDI and whether joining a currency union or trade agreement makes a country more investment friendly.

The next chapter investigates the relationship between political risk and FDI inflows for a sample of OECD countries. As the political risk affects government policies, this study aims to examine the impact of political environment on foreign investments from the perspective of government spending (especially on military), political orientation of the ruling party, form of government in the country, timing of elections, duration of time each political party has remained in power, age of parties and control of all law-making houses by the ruling party.

Chapter six discusses the determinants of FDI in the context of Eclectic Paradigm. This chapter analyses different variables in the context of each sub-paradigm. Along with location-specific determinants, this study uses legal origin of countries as a basis for analysing the internalization aspect. Ownership-specific advantages are also considered within the empirical model.

Conclusions of the empirical chapters of the thesis are drawn and some final remarks on policy implications for investors and governments made in chapter 7. In the end, the chapter gives a description of the limitations of the study and some directions for future research.

Chapter 2

Literature Review on Motives, Trends and Theories of FDI

2.1 What is Foreign Direct Investment (FDI)?

2.1.1 Definition

Foreign Direct Investment is a process where businesses and individuals invest in an enterprise across national boundaries in an effort to explore new markets, to obtain resources and to expand their businesses (Daniels et al. 2004). IMF Balance of Payments and International Investment Position Manual (6th edition) (2009:101) defines Foreign Direct Investments as follows:

> *"Immediate direct investment relationships arise when a direct investor directly owns equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise. "*

FDI is the ownership of fixed assets where foreign investor holds a sizeable share of an enterprise and can exercise his/her voting rights to effectively control the management of the enterprise. The required management control factor differentiates FDI from portfolio investment, which is another type of international investment. FDI involves lasting interest of investors in an enterprise, as it is a long-term investment

undertaken abroad by investors. According to IMF Balance of Payments Statistics (2009), FDI is the aggregate of reinvested earnings, short-term and long-term capital and equity. Short-term and long-term capital transfers include the inter-company loans between parent and subsidiary, purchase of fixed assets such as property, machinery or plant (either for existing subsidiary or as greenfield investments) and other business-related transactions (Williams and Williams 1998; Blanchard et al. 2007).

2.1.2 Difference between FDI and Portfolio Investment

International investment is classified in two types, namely FDI and portfolio investment. The main difference between the two is the percentage of ownership in the enterprise. The portfolio investment is smaller in scale (less than 10 %) of voting shares and does not lead to management control. It is primarily profit-driven and not oriented towards taking over the managerial process. However, FDI is a long-term investment in the fixed assets of a foreign enterprise, which involves a variety of transactions among the foreign investor and the enterprise in addition to equity investment to attain long-term corporate, generic or global objectives. Further, FDI may bring or phase in intangible assets such as goodwill, brand recognition and corporate intellectual property rights (trademarks, patents, copyrights, business methodologies) which portfolio investment does not. Another important difference between portfolio investment and FDI is that the former requires

transfer of ownership/possession rights which is optional for the latter e.g. joint ventures. The portfolio investment is a kind of small scale investment which is usually undertaken by individuals and organisation, whereas FDI is a lasting cross border investment by corporations (Dunning and Dilyard 1999).

Much has been written about the relationship between both of these kinds of international capital movements. Dunning and Dilyard (1999) found FDI and portfolio investments complementary to each other in their study of investment flows in Latin America and East Asia. Hymer (1960) was the first, who clearly differentiated between these two types of international investments in his doctoral dissertation.

2.2 Modes of Foreign Direct Investment

Strategically, among the most challenging decisions for firms to make before international investment process is to select the method or mode they should undertake FDI in a country. FDI is categorised into mergers and acquisitions and greenfield investment on the basis of mode of entry into international markets. Both of the methods have different implications for international businesses. However, less empirical work has been done on greenfield investments and mergers and acquisitions.

2.2.1 Greenfield Investment

Greenfield investment is defined as establishment of all operations from the ground across the border. This kind of direct investment usually occurs when firms have comparative advantage in relation to existing local producers such as brand, technology, marketing or managerial skills. One of the advantages of greenfield investment is that it is purpose-built by investor and fulfils all the specification and requirements. In case of greenfield investment, foreign firm primarily uses its own assets along with local resources (Meyer and Estrin 1999).

2.2.2 Mergers and Acquisitions

There has been an increase in number of mergers and acquisitions taking place in recent years in the entire world (UNCTAD 2007). International investors purchase part of or whole existing running business in order to avoid taking chances of acceptability in the foreign market. The reason might be the advantages of knowledge and access to network of suppliers, raw material, established channel of distribution, brand name and local and international clientele. Meyer and Estrin (1999) name these brownfield investments. In this kind of FDI, the acquired firm may not fully satisfy the specifications of foreign investors. Therefore, international businesses significantly reconstruct the acquired firms in emerging markets (Meyer and Estrin 1999). These occur where most of the main processes in

organization are restructured, for example plant operations, advanced technology, marketing and managerial skills, and international brand names.

2.2.3 Joint Ventures

Joint venture is defined as the process, where two or more corporations decide to work in cooperation to accomplish business goals. In that process, they share some resources and assets for some limited time period and their businesses and entities remain separate. This kind of investment is based on contractual agreement, which states the duration, controlling rights of each corporation, and how much share of profit or loss each will have. Joint ventures may have different reasons for their existence. Motives of joint ventures include gaining access to new markets, key resources, developing better distribution networks and improving research and development capabilities of their businesses (Gaughan 2005).

2.3 Types of FDI

Foreign direct investment is classified on the basis of motives and comparative advantages. FDI is categorized into two kinds (inward and outward FDI) on the basis of directions of investment transactions. Further, FDI is classified into horizontal and vertical on the basis of production processes and value added activities for products.

2.3.1 Vertical FDI

Vertical FDI is a type of foreign investment, in which firms have plants in many countries and various stages of the production process take place in number of locations depending on specialisation to gain the benefits of lower cost of factors of production. Vertical FDI is complementary to trade, as firms export and import goods from parent and subsidiary plants. Therefore, increase in trade barriers (which raises trade cost) in any country has negative effects on vertical FDI (Levy Yeyati et al. 2003). Vertical FDI may take place due to natural resource-seeking, efficiency-seeking or strategic assets or capability-seeking FDI, as this kind of FDI occur in countries with comparatively diverse resources (Blanchard et al. 2007).

2.3.2 Horizontal FDI

When an enterprise produces standardized products to supply local markets in more than one location due to increase in demand worldwide, this is called horizontal FDI. Horizontal FDI is considered substitute to trade, as this kind of FDI occur in response to higher tariffs and transaction costs such as transportation of goods over long distances, which may discourage trade (Daniels et al. 2004). Another reason for horizontal FDI is that firms want to avail the benefits of economies of scale leading to increased production efficiency, as FDI takes place in countries with same cost of factors of productions and same size of countries. Firms would prefer the mode of trade

over FDI, in a country where costs of factors of production are different and trade barriers are lower (Levy Yeyati et al. 2003; Alon et al. 2010).

2.4 Motives of FDI

The reasons due to which firms invest abroad could vary across companies. Why do firms involve in the activity of foreign production? What are the possible reasons for the investors that motivate them to invest abroad? The motives of firms may vary with the increase in experience and successful growth. The motives of FDI are given below:

2.4.1 Resource-seeking FDI

One of the main incentives for FDI is the competitive strategy of minimizing the costs of resources in order to earn more profit and become more competitive. Foreign investors decide to invest across the borders to obtain the resources at prices lower than in their home country. Enterprises may engage in resource-seeking (supply oriented) FDI in accordance with the nature of their business. According to Dunning (1993), resource-seeking FDI can be classified into three kinds: physical resource seekers, cheap labour seekers and those who seek to acquire organisational skills such as technological, managerial or marketing expertise. Physical resource seeking enterprises are usually primary producers or manufacturing enterprises, which use FDI to acquire primary or physical resources, such as raw

materials at lower prices. For instance, FDI outflows from China consist of large investments in natural resources. Eiteman et al. (2010) calls this raw material seeking motive, which incentivises businesses that search for raw materials such as oil, timber, metals and gas. In 2005 and 2006, Chinese state-owned corporations China National Petroleum Company and Sinopec purchased PetroKazakhstan and Udmurtneft respectively (Alon et al. 2010). Other labour intensive organizations from countries where labour costs are high invest in developing countries to take advantage of cheap labour. These natural resource oriented investments have trade and welfare creating effects for the home country, as it increases the purchases of those commodities in which they have comparative disadvantage (Kojima 1973).

2.4.2 Market-seeking FDI

Firms also engage in FDI due to other incentives. The market-seeking (demand oriented) motive for FDI includes four main reasons because of which an enterprise may set up a foreign production. First, FDI occurs when an enterprise invests in the same countries where their major suppliers and customers have expanded their businesses. This way, market-seeking FDI reduces their cost of production, as it helps them to cut transportation cost. In that case, foreign investment takes place to maintain the existing markets and customer base (Dunning 1993).

Second motive for FDI is to produce goods while keeping in touch with local market so as to take good consideration of consumers' tastes and

preferences, trends, traditions, legal and business requirements. In that condition, a business might realise the importance of operating from the required market to satisfy the needs of the customers and requirements of marketing (Eiteman et al. 2010; Dunning 1993).

Further, international businesses decide to apply aggressive or defensive policies. Foreign investors often decide to adopt defensive strategies, where they open plants at the markets near the competitors to maintain physical presence at the target market. Aggressive policies include cross-border investments to reach new markets where they have less competition and more opportunities to generate demand (Madura and Fox 2007; Dunning 1993).

Another reason for FDI to take place is the increase in tariffs and trade barriers by host country governments, which makes trade costly and difficult and makes FDI a better choice for firms (Dunning 1993). Usually, these host country governments encourage FDI in the country when they increase trade barriers.

2.4.3 Efficiency-seeking FDI

Efficiency-seeking (rationalized) FDI is usually defined as any form of market-seeking FDI taking place to gain more cost efficient international production (USAID 2007; Dunning 1993). Efficiency-seeking FDI increases in countries, which support trade liberalization policies (USAID 2007). It is divided into two types: one takes place in markets in which location-specific

business inputs can be obtained at cheaper cost allowing thus to lower production cost, especially in developing countries or to obtain technology, information and capital in developed countries (Eiteman et al. 2010; Dunning 1993). Another kind of efficiency-seeking FDI takes place from one developing country to other, with no major differences in economies, to avail the opportunities of economies of scale and scope (Dunning 1993). This motive has led to an increase in FDI from developed to developing countries, especially due to low-wage labour. Efficiency-seeking motive is most likely a result of the decrease in economic distance or total landed cost among the developed and developing countries, which includes trade barriers and costs of transportation (Dunning 2000b; Eckel 2001).

2.4.4 Strategic-assets or Capability Seeking FDI

This kind of FDI occurs when foreign investors want to access a new technology or business methods, to acquire brand name and to maintain or enhance their ownership advantages or competiveness in international market (Eiteman et al. 2010; Dunning 1993, 2000b). Earlier, it was the firms from developed countries that were observed to undertake strategic-asset seeking FDI. Recently, there has been an increase in such kind of investments from companies that already have cheap labour and resources available in their home countries, but are motivated towards developed countries primarily to acquire new technology, expertise and innovation in businesses.

2.4.5 Political Safety Seeking FDI

Eiteman et al. (2010) argue that international investors seek safety from expropriation risk, as countries seize the accounts and impose restrictions on capital movement in the state of political unrest in the country. The reason for such unpredictable government actions might be that developing countries are deficient in terms of ingrained institutional, legal and regulatory framework (Pongsiri 2005). Therefore, foreign investors select politically stable countries for their preferred location, as FDI is a long-term investment. The increasing trends and patterns of FDI to developed countries show this preference of foreign investors, as developed countries have less risky environments. In this case, multinationals analyse the political environment affecting the economy of a country.

2.5 Trends of FDI

In this section, I report the global FDI trends by analysing the reported data on FDI inflows. Important highlights of these trends are given below. Over the past three decades, Foreign Direct Investment (FDI) inflows increased consistently from US$13 billion in 1970, to US$207 billion in 1990 and US$1.24 trillion in 2010 (UNCTAD 2011a). Foreign direct investment flows are still on the road to recovery from the 2009 or 2008 crisis and its aftermath. The data shows the shift of FDI inflows from developed economies to developing economies. Among the developing economies, Asia

and Oceania are those regions where on aggregate, FDI inflows decreased from 2009 to 2010 (UNCTAD 2011a). South-eastern Asia and developed economies of America show a robust growth in FDI inflows. The crisis has affected investors' trust, which resulted in a shift of FDI from less developed countries of Africa to Latin America, East and South East Asia. This changing pattern of FDI has been described in literature, as has been attributed to political safety seeking. Further, global and unpredictable economic environment of countries is thought to be the reason for slow growth in FDI as compared to trade. As can be seen in Figure 1 from 1970 to 2010, FDI inflows show an increase in the years of 2000 and 2007 and downward trends after 2007 due to the crisis (UNCTAD 2011a).

There are two peaks in the graph of global FDI inflows, one around the year 2000 and other just before the crisis in 2007. World FDI inflows dropped severely by around 51 per cent in 2001, which was the first drop in FDI inflows after stable growth since 1991. The reasons behind this phenomenon might be the slowdown of production, distribution and consumption of goods and services at all levels within developed countries and a critical decline in the activities of stock market. These changes have decelerated the cross border mergers and acquisitions activities, which were the main source of FDI. This situation has a major impact on the FDI inflows of developed countries as compared to developing countries which experienced a reduction of 59 per cent and 14 percent respectively within the

years 2000 to 2001 (UNCTAD 2002:3). The transition economies of Central and Eastern Europe (CEE) are the only ones that remained unaffected.

The increase in global production is determined by an implementation of national policies fostering continuous process of openness of FDI and trade and changing economic and technological forces. The competition for export oriented FDI is predominantly thought as this kind of FDI supports the balance of payments and export competitiveness of nations (UNCTAD 2002:3). During the period of 1980-2000, global FDI inflows increased speedily and more rapidly than world exports and world GDP relative to other capital flows (Wong and Adams 2002:6; Zimny 2004). Especially, the increase in FDI inflows in the years 1999 and 2000 is mostly linked with IT (technology) bubble which seemed to have cause a surge in foreign investments (form of a growing number of cross-border M&As) in developed

Figure 1 FDI Inflows as a Percentage of GDP

Source: UNCTAD STATS database.

countries due to highly developed technology in correlation with "the sudden growth in the US economy and equity market boom" (Wong and Adams 2002:7). However, the decrease in FDI inflows in 2001 seemed to have reverted back to the 1998 level (Wong and Adams 2002).

2.6 Theories of Foreign Direct Investment (FDI)

Various theories have been developed to define and describe the operations of multinational enterprises since 1960s. These theories attempted to answer some important questions about the field of international business. Who is the investor and why do firms from some particular regions invest more? What kind of FDI is taking place in the entire world and what derives the trends of FDI? Why do firms decide to undertake FDI rather than trade or franchise? What are the motives of different firms for FDI? Why FDI is usually concentrated in few geographical areas? What are the modes of entry of enterprises in international markets? The answers to these important issues help in analysing grounds of various theories (Gladwin and Giddy 1973). Theories of FDI are categorised into microeconomic (firm level), meso-economic (industry level) and macroeconomic (country level) (Cantwell 2000), and theories assuming perfect and imperfect markets, and determinants of FDI (Moosa 2002). The list of theories for this study has been inspired by (Moosa 2002; Cantwell 2000). In what follows, I present an account of theories at different levels and several modifications have been introduced.

2.6.1 Classical Theory of International Investment / Differential Rates of Return Hypothesis

Classical theory of international investment present the hypothesis that international capital movement is the result of variation in interest rates in different countries in case of perfect market conditions (see Gladwin and Giddy 1973 for a detailed literature review). According to this hypothesis, there are two groups of countries, capital abundant and capital-scarce countries (in short supply of capital). Capital abundant nations offer lower rate of returns on capitals and capital-scarce countries offer higher interest rates in order to attract more investments. As the main objective of firms is to earn profit, they are believed to invest abroad in expectation of higher marginal returns in comparison to the additional cost of capital (Lizondo 1990). Therefore, long-term and short-term capital from capital abundant nations moves to capital-scarce countries to maximise the rate of return. This process continues until the return on capital is equalized by capital flows.

This theory gives a reasonable justification of worldwide capital transfers before World War II, which were mostly in terms of portfolio investments (Gladwin and Giddy 1973). However, it does not offer much explanation for the ownership and control aspects of FDI, as it is only concerned with funding or acquisition of capital for international investments. The reason for this may be that at that time, FDI and portfolio investments were not clearly classified into separate forms of investments (Dunning and Dilyard 1999). Further, firms do not always transfer capital

from home country for direct investment. Sometimes, FDI takes place in both capital abundant and capital scarce countries simultaneously. This theory is unable to explain this (Gladwin and Giddy 1973; Lizondo 1990), as it assumes that capital only moves in one direction. In fact, cross movements of capital may occur when uncertainty about capital returns increases or the risk preferences of investors change (Hymer 1960). This theory assumes that international investors are risk neutral and only interest rates affect international investments. A survey of empirical studies for differential rate of return hypothesis can be found in Agarwal (1980).

2.6.2 The Location Hypothesis

The foundations of the location hypothesis can be traced back to an early study of Mundell (1957), which postulates the relationship of FDI and immovable factors of production, while discussing the factor endowment model. There are certain business inputs, which are immovable and available only in certain specific areas, such as labour or natural resources associated with land factor (e.g. steel). Since it is costly for firms to import these resources, FDI takes place. According to the location hypothesis, firms undertake FDI in order to avail the benefits of cost of factors of production (Moosa 2002). However, the empirical studies found mixed results on the effects of wages, as unionisation and labour disputes have varying impact on FDI.

2.6.3 The Monopolistic Advantage Theory / Industrial Organization Hypothesis

The Monopolistic Advantage Theory was presented by Stephen H. Hymer (1960) in "The International Operations of National Firms: A Study of Direct Foreign Investment" at MIT. Before this theory, classical theory of international investment was only concerned about capital transfers in the environment of perfect competition, without much difference of what kind of investments and who makes these investments. But Hymer's theory is considered a breakthrough concept of direct investments by multinationals enterprises (Gladwin and Giddy 1973). According to this theory, firms face the problems of political uncertainty, market unfamiliarity and increased transactions costs due to distance, but would decide to invest abroad when they have sustainable competitive advantages in terms of product innovation and differentiation, marketing or managerial expertise, new technology, economies of scale and scope (Hymer 1960; Eiteman et al. 2010). Gladwin and Giddy (1973) call investment on the basis of some advantages a very brave approach, which differentiated this theory from classical theory. In general, domestic businesses have better market knowledge (such as customers' tastes and preferences) and access to different suppliers and channels of distribution advantages. Firms which go international must possess some monopolistic advantages, which help them survive in a perfectly competitive market of a foreign country. Firms prefer to undertake FDI (as opposed to other available options such as licensing and franchising)

due to the non-transferable nature of these intangible advantages. In case of valuable information (for instance new technology or product innovation), it is a better option to not to reveal their business secrets to other/local firms (Moosa 2002). As in this condition, the firm will lose its comparative advantages. However, Hymer's theory does not explain why firms prefer FDI over exporting from home country. On what basis do firms decide to invest in some countries not others (Moosa 2002)?

Hymer's work accentuated the attention of international business scholars from the movement of international capital to the importance of multinational enterprises (Rugman 1999). Rugman (1999) call the empirical study of Dunning (1958) as groundwork for Transnational Corporations (TNCs), which had a significant effect on Hymer's study (he has also cited as a reference in support of his results in his thesis).

2.6.4 The Theory of the Market

According to Kindleberger (1969), FDI cannot take place in the environment of pure competition. In case of the condition of pure competition, trade is the most appropriate option for the businesses. In other words, market imperfections attract foreign investments in the states. Market imperfections can be designed through goods market (product differentiation, pricing, marketing skills), factor markets (access to capital markets, superior management, proprietary knowledge or better technology), economies of scale (creation of internal and external economies of scale) and government

imposed disruptions (governments' intervention in the production and trade, namely restricting output and entry) are the pure imperfect competition conditions that attract the foreign investments in the countries. These market imperfections give a firm the monopolistic advantage over the domestic businesses and would motivate them to invest abroad (Hymer 1960).

2.6.5 The Product Life Cycle (PLC) Hypothesis

Product life cycle hypothesis was proposed by Raymond Vernon (1966). According to PLC hypothesis, international production is the result of the development of a product to the standardized stage. Vernon (1966) classified the product life cycle into three stages, where first a new product is introduced; it matures and then becomes a standardized product with the continuous process of improvements in inputs, processes and technology. When a product development is in the initial stage, firms require cheap inputs so that they can improve the product at lower cost. In this situation, firms would like to produce in those countries where they have access to cheap inputs, technology and ease of communication with customers, suppliers and even competitors. According to PLC theory, firms undertake foreign direct investment in developed countries (e.g. United States) in the first stage with a non-standardized and new product to gain access to latest technology, skilled labour and to remain close with the market (customers with high incomes). At this stage, the product is exported to other markets. Firms produce

standardized product in any part of the world at lower factor costs as then a firm enjoys benefits of economies of scale and does not require extensive research and development costs, change in processes and has less need to communicate with customers. According to this theory, FDI takes place in the final stage of product development cycle in response to the increasing competition in the world.

Rugman (1999:54) criticized Vernon (1966) for assuming Japan and Taiwan Province of China among "less-developed countries" and that his study was limited to United States (US) TNCs.

2.6.6 The Internal Financing Hypothesis

The internal financing hypothesis discusses the important concept of financing between parent and subsidiary firms. According to this hypothesis, multinational enterprises make initial investments in the subsidiary firms. Once the subsidiary firm is operating, it finances the process of further development of plants or subsidiaries by the parent multinational enterprise in the same country from re-invested earnings (Moosa 2002). The FDI literature discusses this financial aspect of the international firms within the context of internal capital market or external financing. According to this hypothesis, direct investments by multinational firms do not always involve the transfer of funds from parent firms to the subsidiary or foreign country where they intend to make direct investments. This investment may take

place in the form of borrowing from host country banks or transfer of funds from parent firm. The choice of internal or external financing depends on the costs and benefits of each method of financing. According to Gertner et al. (1994), internal financing gives control to parent firm which includes increase in check and balance of subsidiary, decrease in entrepreneurial or managerial motivation and suitable redistribution of assets of poor units. However, when the source of external financing (bank lending) is used, the external financer does not own the subsidiary and have different interests in subsidiary as they are less concerned about its profitability and success. Managerial or entrepreneurial incentives are high in such kind of financing as managers are able to obtain the fruits of their hard work. External financer sells the business in the situation of failure and the return of their full funds is not certain as they may not get back their investment.

2.6.7 The Market Size Hypothesis

The market size hypothesis is still widely used and recognized hypothesis in the FDI literature, especially in empirical studies. Market size hypothesis postulates that the magnitude of FDI is based on the size of the market or economy of host nation. When the size of host country economy increases, it brings the advantages of economies of scale and scope through specialization of primary resources. These advantages reduce the cost of production along with increase in sales and, therefore, attract FDI inflows in the country (Moosa 2002). The Gross Domestic Product (GDP) and GDP

growth rate variables are usually obtained to test this hypothesis, which shows the current economic conditions and expected changes in the economic conditions of that country.

The market size hypothesis recently acquired a new dimension after the emphasis on the impact of regional trade agreements on FDI. The membership in regional trade agreements are considered to increase the market size of related countries, causing an increase in international investments even to a greater extent. This hypothesis attempts to answer the question of why FDI goes to certain group of countries.

In the FDI literature, the investigation of the effects of market size on FDI is frequently done on the basis of its structural importance for direct investments. There seems to be little explanation of the theoretical background of the hypothesis (Lizondo 1990). Further, Lizondo (1990) describe that the determinants of market size and growth rate are important when the direct investment aim to serve the local consumers and are assumed to be ineffective for export oriented FDI (as then market size or growth does not have any significance for FDI theoretically).

2.6.8 The Currency Areas Hypothesis and the Effect of the Exchange Rate (The Aliber Theory of Foreign Direct Investment)

In 1970 Robert Aliber proposed a theory which investigates the impact of differing values of currencies and economic integration on the FDI, as

measured by the existence of customs unions, single currency areas and separate currency areas. Aliber (1970, 1971) argues that firms' decision to invest in any particular customs union is influenced by tariffs. Firms are motivated to invest in a customs union member country in order to be able to export to other member countries with less or no tariffs. FDI has a tendency to increase for a country, which becomes a member of a customs union (Motta and Norman 1996). Further, Aliber (1970; 1971) asserts that firms investing in single currency areas face transportation costs instead of tariffs and location decision of firms is influenced by easy access to markets, availability of material and prices of factors of production.

Aliber (1970) avers that in separate currency areas, international investments are contingent on disparities of exchange rates. Firms from strong currency countries will invest in weak currency countries due to the increased purchasing power. In other words, an appreciation or revaluation of a currency appears to be associated with Outward FDI (OFDI), whereas a depreciation or devaluation of the currency could be linked to FDI inflows. Aliber's theory did not get much recognition as a theory of FDI and was criticized for being limited to financial parts of FDI, especially the currency areas (Dunning 1993, 2001; Ietto-Gillies 2007). On the other hand, it is widely used to evaluate the effects of exchange rates on FDI.

There are contradictory results on Aliber's theory of FDI in different empirical studies. For instance, Farrell et *al.* (2004) observe that appreciation of Yen increases Japanese OFDI; however their finding is statistically

insignificant. Kyrkilis and Pantelidis (2003) find mixed results, in that exchange rate is significantly negatively correlated with OFDI for three countries i.e. France, Brazil and Singapore; while the coefficient on the exchange rate is statistically significant with a positive sign for United Kingdom (UK) and Argentina and statistically insignificant for Italy, the Netherlands and Korea.

Agarwal (1980) describes that most empirical studies conducted on the FDI of developed countries found the results in harmony with the Aliber's theory of FDI. However, Lizondo (1990) points to the weaknesses of theory in that it does not explain concentration of direct investments in some particular industries, FDI among different currency areas and between the member countries of same currency area and the "hedging or a diversification" benefits to strong currency firms only.

Although, the topic of the relationship between exchange rate and FDI is much discussed and tested empirically, more clarification is needed as to how and why FDI is affected by exchange rate, as FDI (recorded in capital account) does not have a direct relationship with exchange rate (Busse et al. 2010; Froot and Stein 1991). Further, Froot and Stein (1991) give a clearer explanation of the issue by stating that FDI inflows increase in the weak currency country, as the depreciation of the real value of currency apparently makes some information intensive assets with high monitoring cost cheaper to foreign investors. In a way, it increases wealth of foreign investors and motivates them to invest more. Further, earlier studies assume that exchange

rate is an important factor in terms of transfer of revenues from subsidiary to parent company (Busse et al. 2010). Froot and Stein (1991) emphasize the role of wealth for the importance of the exchange rate - FDI relationship and state that previous studies used profits and other determinants affecting FDI only because they increase the wealth of the enterprise, which motivates to increase FDI.

Busse et al. (2010) identify three major areas of study in this field: the effects of exchange rate, its volatility and membership of currency unions on FDI. The changes in exchange rate bring changes to the profits, market value and net cash flows of firm, as they affect the transactions and operations of the firms (Eiteman et al. 2010).

2.6.9 The Oligopolistic Reactions Hypothesis

In 1973, Knickerbocker put forward the idea that enterprises decide to engage in foreign investment due to reaction of international investments by their business rivals in the oligopolistic market. Firms are motivated to invest in those geographical areas to maintain the market share, where their competitors invest. This strategy is also called ‘follow the leader’ (Meyer 1998; Moosa 2002) as the concentration of FDI in a particular industry occurs in chain reaction.

Oligopolistic reaction hypothesis explains the concentration of direct investments in some particular industries over the same time in a new market, which is usually the result of FDI by the top investor followed by other

competitors. Oligopolistic reaction is basically "risk minimizing behaviour employed by firms to reduce the perceived competitive threats of other members of their oligopolistic industry" (Flowers 1976:43). Flowers (1976) conduct an empirical analysis of the hypothesis of oligopolistic reaction for European and Canadian FDI in United States and find oligopolistic reaction FDI occurs within the 3 years of FDI by leading investor. According to Flowers (1976), the limitations of this theory includes the lack of clarification of why leading investors undertake FDI in a particular country and the point that this theory might not be able to explain the oligopolistic reaction FDI in other countries, as it was proposed in the context of concentrated FDI in United States.

2.6.10 The Comparative Advantage Theory of Kiyoshi Kojima (1973, 1977)

The comparative advantage theory was first presented by Kojima (1973, 1977). It differentiates Japanese FDI from American FDI and their effects on domestic and international trade and investments. According to this theory, there are two types of FDI: trade-oriented FDI and anti-trade-oriented FDI. Kojima (1973) claims that Japanese FDIs are basically trade-oriented as Japanese investors undertake FDI in the industries where they have comparative disadvantage in the home country. Therefore, Japanese direct investment in the countries which have comparative advantage in these industries helps in the process of exporting the products back to the home

country. In this way, FDI helps in creating jobs and welfare oriented trade, creating effects for the recipient country.

On the other hand, anti-trade-oriented FDI (American FDI) is a kind of direct investment that takes place in those industries in which firms have comparative advantage and they could export these products from domestic market. Thus, this kind of FDI not only replaces exports with imports but it also affects negatively the local employment and balance of payments and encourages the country to apply protectionist policies. United States of America (USA) economy is described by Kojima (1973) as a dualistic structure, because investments are done by new or oligopolistic industries and traditional industries. USA FDI is basically new industry-oriented, as most direct investments are done by those firms which constantly develop new products with research and development. They also have comparative or monopolistic advantage and due to this reason they are in a better position in terms of FDI than traditional industries (which are considered stagnant and are not involved in innovation and creativity). These investments are detrimental to the economic development and welfare of both home and host country's national interest in the long run.

Therefore, Kojima (1973) suggests that home country governments should play an important role in terms of policy implementation in order to make direct investments beneficial for both the countries. These policy recommendations include: government intervention in the selection of proper industries for each host country, and giving preference to licensing and joint

ventures, as these modes of international business help in the transfer of knowledge (which is called public good by Kojima) to the host countries. Foreign investors should pass on the possession of business to domestic companies of host country gradually. FDI should be encouraged in those industries which serve large mass of consumers and which transfer technology by keeping in view the host country factor proportion. In order to encourage trade-oriented FDI, trade barriers should be eliminated or relaxed and "monopolistic behaviour should be strictly controlled" (Kojima 1973:19).

According to Kojima (1973), America and other anti-trade-oriented FDI countries should first of all try to break the dualistic structure system. On the whole, Kojima's theory emphasizes the role that developed countries can play in an effort to increase welfare and benefits to developing countries.

2.6.11 The Internalization Hypothesis

The internalization hypothesis was proposed by Buckley and Casson (1976), and was inspired by the work of Coase (1937) titled "The Nature of the Firm". Coase (1937) asserts that the reason for firms to undertake FDI is to substitute the market or exchange transactions. According to internalization hypothesis, firms internalize the foreign markets (for intermediate inputs and outputs) to replace the transaction costs (Buckley and Casson 2009). Therefore, they invest in countries where they obtain these resources at cheaper costs. Firms have the incentive to internalize until they reach the limitation, where their internalization costs exceed the marketing or

exchange transactions cost. These firms exist on the basis of continuous research and development in terms of innovation in products, processes, methods and technology (Buckley and Casson 2009). The process of internalization takes place due to the problems associated with market imperfection and requires location-specific important strategic decisions. Firms internalize their operations to circumvent the difficulties associated with buyer uncertainty, which eventually affect the supplier uncertainty issues such as lead time, inventory, and responsiveness to customers. Benefits of internalization include the control of resources, such as availability of resources or intermediate goods on time and reduction of intermediary cost. Internalization hypothesis explicate why firms undertake FDI over licensing, trade (export & import) and franchising. Internalization has been classified into two types: operational internalization (transfer of intermediate products after different operations) and knowledge internalization (transfer of knowledge to other plants after research and development activities) (Buckley and Casson 2009). Knowledge internalization is significant and preferred due to information gain.

2.6.12 The Investment Development Path (IDP) Paradigm

The hypothesis of Investment Development Path was proposed by Dunning (1981a) in juxtaposition with Eclectic Paradigm. According to IDP paradigm, change in the level and stages of development of a country's

economy affects the flows of domestic and international investments. On the other hand, FDI flows also have diverse effects on the economic development of a country (Buckley and Castro 1998). This investment development path includes all nations from less developed, developing and developed countries.

Dunning (1981a) analysed the data of 67 countries for the period of 1967-1978 and proposed the stages of investment development path on the basis of level of economic development and income level of countries. The first stage consists of the developing countries characterized by widespread poverty with a small amount of inward investment and no outward investment. This shows lack of ownership advantages, which could incentivise investors for outward FDI and the use of other methods of international business such as increasing imports and decreasing exports. The reason for small inward investments is associated with small market size of these countries, underdeveloped legal and institutional framework, unskilled labour, inadequate infrastructure facilities and government interventions to protect home industries. Inward investments are usually channelled towards natural resource seeking, which are few at this phase (Gorynia et al. 2010).

The second stage describes the group of countries whose inward direct investment increases gradually. This level may be supported by an increase in market size of country and change in government attitude towards inwards investments (for instance making conducive policies and regulations to replace imports with FDI). Outward investment pattern has just developed and is not very significant yet mainly because of emerging ownership

advantages of domestic firms. At this point, foreign firms are motivated to invest due to improved domestic location-specific advantages, such as natural resource-seeking, market-seeking and efficiency-seeking incentives.

Increase in inward investments plays a very significant role in the development of the economy of host country, for instance, by increasing employment, training and skill enhancement of local labour, utilization of local resources, and transfer of know-how to local firms. This helps local firms to develop their ownership specific advantages, which lead them to internalization process (Fonseca 2008).

In the third phase, ownership-specific advantages of foreign firms become more specialised due to technology development or decline along with location specific advantages and internalisation advantages increase. Third stage includes developing and emerging countries alike. During this phase, negative net outward investment of these countries gradually decrease whether due to increasing outflows in comparison to inflows or decreasing inflows. During this phase, domestic firms invest abroad to exploit large markets and to gain strategic assets (Fonseca 2008).

This kind of trend continues in the fourth stage, where negative net outward investment turns into positive outward investment with developed countries' increase in Gross National Product (GNP) per capita. Here, ownership-specific advantages of foreign firms become more enhanced or decrease along with location-specific advantages of host country. In this phase of investment development path, outwards investments grow due to

increase in ownership and internalization advantages from these countries such as created assets (capital intensive production, "...sophisticated markets, qualified labour, technological capacity of the more dynamic sectors, development of economies of agglomeration..."(Fonseca 2008:6) become an essential feature of location-specific advantages of country.

The fifth stage of IDP features in developed and high income countries such as United Kingdom and United States of America. The net outward investment position, at this stage, shows a tendency to vary around zero, as it is affected by exchange rates and economic cycles. The countries at this level have high inward and outward investments and similar economic structures, which affects the association between international investment position and economic development (Fonseca 2008).

Fonseca (2008) finds results which are in harmony with the IDP theory and uncovers an association between net outward investment position and GDP of countries. Many empirical studies were conducted to test the hypothesis including those using time series data and cross-sectional investigations focusing on a number of countries (Narula and Guimon 2010).

2.6.13 Eclectic Paradigm – Dunning

The Eclectic Paradigm by John Dunning (1977, 1980, 1993, 2001) addresses three important issues 'why', 'where', and 'how' of international production. Dunning (1980, 1993, and 2001) states that international production is a result of three main factors i.e. Ownership, Location, and

Internalization (OLI). The capability and propensity of a country's firms to engage in foreign investments is subject to the possession of certain ownership specific assets such as managerial skills, patents and technology. The second component of OLI paradigm comprises of those factors which are accessible to firms of a particular country, such as natural resources, level of human capital available to businesses, market size and infrastructure costs. Therefore, location factor derives foreign firms to invest in those countries to obtain resources at cheaper cost. The third factor consists of the decision of the firms whether to invest in a foreign country, export or sell the rights of product to local firms. Internalization is the process where firms decide to undertake FDI instead of exporting or franchising. Internalization factor may be promoted by government policies such as the appropriate mix of taxes and tariffs. According to Dunning (1981b), firms opt for FDI when they have all these three advantages: ownership of special assets, internalization and location advantages as motivational factors. On the other hand, firms would decide to export if they have ownership and internalization benefits. The decision about contractual transfer of resources is preferred by firms in a situation when they only possess ownership advantages.

The ownership advantages are classified into two types (Dunning 1981a). The difference between the two advantages is that the first kind of ownership assets needed to be internalized and the other does not necessarily require any explicit way of use for gaining benefits. The first type consists of non-saleable assets such as "genuine joint economies of hierarchical

activities, e.g., product and process integration, the spreading of managerial and technological capacity, the reduction in transaction costs and the gains arising from asset, product or market diversification"(Dunning 1981a:33). And the second assets include marketing, managerial or organizational skills, patents and trademarks.

Dunning (2001) asserts that Eclectic Paradigm is still appropriate and continues to be significant for the analysis of OFDI from the developing countries. However, some empirical studies (Banga 2007; Buckley et al. 2007) criticise the Eclectic Paradigm for being a theory relevant to the FDI from developed to developing countries and argue that it is unable to account for developing FDI flows in the opposite direction. Cantwell (2000) does not regard Eclectic Paradigm as a separate theory, but a blend of a variety of approaches to explain the operations of multinational enterprises. This study intends to examine the impact of OLI factors in determining the international investment decisions.

2.6.14 Political Risk Hypothesis

All investors face certain non-financial risks during the process of international investment. Political risk is one of the important decision-making factors which could deter the FDI inflows. Volatile social and political situation may create systematic risk, which affects all the economic activities of that region. Political risk is generally described in terms of unexpected events associated with government actions or policies which may

have positive or negative consequences for economic environment of a country (Kobrin 1979). However, Edwards (1990) divide political risk in two categories, political instability (i.e. probability of regime change) and events of political violence. In general, the supportive political environment of a country invites investments and negative socio-political conditions or events such as conflicts, change of governments and political assassinations could decrease FDI inflows into a country.

Eiteman et al. (2010) categorize political risk into three types: firm, country and global-specific risks. Firm-specific or micro risks are those which Multinational Enterprises (MNEs) might face on the corporate level. Firm-specific risks mainly consist of governance risk (the disagreement between the goals and objective of host country government and MNE), exchange risks and business risks. This includes the issues related to how much control a foreign firm should be allowed and the nature of industry (investment in key industries i.e. defence industry). It also captures the impact of foreign firms on the economic growth, exchange rate and balance of payments of host country, resource exploitation (human and mineral resources such as firms' role in the development of local area, standardization of production facilities), customer protection acts and rules. Eiteman et al. (2010) suggest the best solution for governance risks is to analyse and predict the problems and discuss terms of investment agreements with the host country government in advance.

Macro or country-specific risks are the systematic risks, which have different effects on all domestic and international firms. International firms are more prone to these risks in comparison to domestic businesses as domestic firms have long lasting interests in the home country. Country-specific risks consist of transfer risks and cultural and institutional risks. Transfer risks or blocked funds is a situation when a host country government imposes a restriction to move foreign exchange funds out of the country due to the shortage of foreign exchange. Institutional risks involve the requirement to hire a specific percentage of local employees, permissible ownership structures for subsidiaries for instance joint venture or major or minor ownership conditions, and the protectionism for defence, agriculture and infant industries through tariff and non-tariff barriers. Multinationals are more prone to cultural risks in a foreign country, such as the problems of corruption, favouritism, and infringement of intellectual property rights for instance patented technology and copyright materials.

Global-specific risks are the result of critical events or situations in any country of the world which affect multinationals and their subsidiaries worldwide. These are the risks which no multinational can predict or have control of. Terrorism, war, anti-globalization movement, environmental concerns, poverty and cyber-attacks are those risks where multinationals can only support government efforts to solve these problems (Luo 2009).

However, the international business literature presents mixed results for political instability and political risk. For example, Nigh (1985) in an

empirical study of the impact of international and intra-national conflictive and cooperative events finds a significant direct relationship between political events and US OFDI. Tallman (1988) infers that domestic conflicts have a positive effect on OFDI and domestic cooperation has negative effect. Schneider and Frey (1985) find that political instability has a negative effect on FDI flows.

2.6.15 Government Regulations

The operations of multinationals are largely affected by the host and home country government's rules and regulations. They also affect the important decisions of the firms for instance when, where and how much to invest. The changes in government regulations can convert risks into gains and may have a huge impact on the expected returns of international firms (Lizondo 1990). Modifications in government regulations are an outcome of governments' goals. Governments promote or discourage foreign investments due to welfare effects and political reasons (Rugman 1998). There are different welfare aspects, such as protecting and increasing employment and developing infant industries or particular industries in the home country. Other purposes for regulations are to act against the firm-level policies such as "intra-firm pricing and discriminatory input purchases" which are seemingly detrimental to the host country (Lizondo 1990:21). Government influences the decision of investors through the regulations of trade barriers and tax policies.

Trade barriers are the constraints imposed by governments to protect and support their interests. Trade barriers, in any form, be it tariffs or non-tariff barriers are believed to motivate international investors to replace their trade with direct investments in those countries. However, there is a vast literature on the relationship between trade barriers and FDI. It has been an ongoing topic for discussion in FDI literature, whether FDI and trade are substitutes or complements. However, literature distinguishes between tariff-jumping and market-seeking FDI which takes place irrespective of trade barriers (Milberg 1999; Blomstrom and Koko 1997). Even empirical studies consider the variable of openness to trade a very important determinant of FDI. This is due to the increasing number of countries joining international institutions, which emphasizes openness to trade and investment as a vital component of international business.

Tax policies are crucial during the process of location selection for FDI (Benassy- Quere et al. 2005) as they have important implications for the international firms at both home and host country. They have an influence on the method of funding and rate of return on investments of businesses (Lizondo 1990). When it comes to returns on investments, foreign investors have to face the problem of double taxation. Multinational firms have two available options in that situation: territorial approach or residence approach. Countries are making their policies more conducive for FDI. FDI inflows are considered to have high welfare impact on the economy, as they bring the needed funds, increase employment, and generate tax revenue (Becker et al.

2010:1). Therefore, at global level, a decrease in corporate tax rate has been observed. Becker et al. (2010) analyse the quality and quantity affects of corporate taxes on FDI and find that quality of FDI play a much more important role in terms of welfare and contribution to host country economy.

2.6.16 The Portfolio Diversification Hypothesis

According to portfolio diversification hypothesis, risk, along with expected returns, plays an important role in corporate decision making. Businesses spread the risk across investments in more than one place to avoid losing all money at once. This theory received recognition, as it explains why outward and inward FDI takes place in countries simultaneously. However, it was ineffective to rationalize why international investments in certain industries were greater than others. Why international businesses need to spread the risk in a perfect market to increase shareholders wealth? Maybe, it should be shareholders, which require diversifying risk through their portfolio investments, not the firms (Lizondo 1990; Moosa 2002).

2.6.17 Strategic and Long-term Factors

FDI is a long-term stake of investors abroad, which has significant implications for the host countries. Strategic and long-term factors play an important role in the location decisions and the mode of entry into foreign markets by foreign investors. These strategic factors include the policies of multinational enterprises regarding competition, market share, research and

development and bargaining with host governments (Reuber et al. 1973 cited in Moosa 2002: 58). Trevino and Mixon (2004) discuss strategic factors from the point of view of host country government policies and relate it to institutional theory from strategic management literature. The FDI literature on institutional theory investigates the effects of government strategies in terms of liberalization of trade and investment regulations such as bilateral investment treaties, government controls on capital movement across borders and political risk. According to the study of Trevino and Mixon (2004), institutional factors have greater influence on direct investments in a country than macroeconomic variables. Further, Meyer et al. (2008) emphasize that institutional arrangement whether weak or strong have influential impact on the decisions of MNEs whether to enter into a new market through joint ventures, acquisitions or mergers. MNEs require various resources in order to operate and the access to such resources depends on government policies.

2.6.18 The Relationship between FDI and Spatial Interdependence

There has been an increasing discussion of the spatial issues related to FDI since 1990s. FDI is considered to not only affect the home and host country but have the third (neighbouring) country effects on both inflows and outflows of nations (Blonigen et al. 2007), especially where multinational enterprises invest with the main purpose of export platform FDI. In this kind

of investment, MNEs undertake FDI in countries nearer to large markets, so as to use this plant to export to neighbouring regions.

2.7 Main drivers of FDI

Different studies in empirical literature have used diverse determinants of FDI by using/employing different methods depending on their areas of concerns.

Variable	Effects on FDI	Empirical studies	
	No-effect	Negative effect	Positive effect
Real effective exchange rate	Tuman and Emmert (2004)	Froot and Stein (1991), Dhakal et al. (2007), Scheinder and Frey (1985),	Blonigen (1997), Edwards (1990),
Volatility of exchange rate		Li (2006), Ramirez (2010), Bénassy-Quéré et al. (2001),	Goldberg and Kolstad (1994),
Membership of WTO	Neumayer and Spess (2005)		
Membership of free trade			MacDermott (2007), Feils and Rahman (2008)
Preferential PTA			Medvedev (2006)
Bilateral investment treaties			Barthel et al. (2009)
Unit labour cost	Owen (1982), Gupta (1983), Lucas (1990), Sader (1993), Tsai (1994), Loree and Guisinger	Goldsbrough (1979), Flamm (1984), Culem (1988), Schneider and Frey (1985), Shamsuddin (1994), Pistoresi (2000),	Caves (1974), Swedenborg (1979), Wheeler and Mody (1992)

	(1995), Lipsey (1999),		
Human capital –Education		Mina (2007),	Fosfuri et al. (2001), Glass and Saggi (2002), Moosa (2007)
Openness	Schmitz and Bieri (1972), Wheeler and Mody (1992), Khachoo and Khan (2012)		Taylor (2000), Kravis and Lipsey (1982), Culem (1988), Edwards (1990), Pistoresi (2000), De Mello (1999), Dhakal et al. (2007), Mina (2007), Kueh et al. (2008), Lankes and Venables (1996); Holland and Pain, (1998), Asiedu (2002), Sahoo (2006), Edwards (1990), Gastanga et al. (1998), Hausmann and Fernandez-Arias (2000),
Market size	Holland and Pain (1998), Asiedu (2002),	Dhakal et al. (2007), Mina (2007),	Bandera and White (1968), Swedenborg (1979), Rott and Ahm (1979), Lunn (1980), Kravis and Lipsey (1982), Nigh (1985), Culem (1988), Pearce (1990), Dunning (1993), Tsa (1994), Loree and Guisinger (1995), Wheeler and Mody (1992), Shamsuddin (1994), Dees (1998), Billington (1999), Pistoresi (2000), Shatz and Venables (2000), Fung et al. (2000), Li (2006), Schneider and Frey (1985), Ramirez (2010), Lankes and Venables, (1996), Resmini (2000), Duran (1999), Garibaldi

			(2002), Bevan and Estrin (2000), Nunes et al. (2006), Sahoo (2006), Chakrabarti (2001), Khachoo and Khan (2012)
Infrastructure cost			Asiedu (2002), Wheeler and Mody (1992), Loree and Guisinger (1995), Kumar (1994),
Electricity consumed			Khachoo and Khan (2012)
inflation rate	Asiedu (2002)	Buckley et al. (2007), Dhakal et. al (2007), Schneider and Frey (1985), Bengoa and Sanchez-Robles (2003),	
the current account balance (International Financial Statistics (IMF),)		Dhakal et. al (2007), Schneider and Frey (1985)	
reserves			Khachoo and Khan (2012)
Real GDP per capita LCU	Loree and Guisinger (1995), Hausman and Fernandez-Arias (2000), Wei (2000),	Edwards (1990), Jaspersen et al. (2000),	Tsai (1994), Schneider and Frey (1985), Lipsey (1999),
Growth rate of real GDP(GDP per capita growth)	Tsai (1994), Asiedu (2002),		Buckley et al. (2007), Jaumotte (2004), Kravis and Lipsey (1982), Culem (1988), Edwards (1990), Pistoresi (2000), De Mello (1999) Lunn (1980), Schneider and Frey (1985), De Long and Summers (1991), Levine and Renelt (1992), Culem (1988),

			Blomstrom et al. (1992), Borensztein et al. (1998), Billington (1999), Lim (2001), Durham (2002), Chakraborty and Basu (2002), Li (2006),
Double taxation treaties	Neumayer (2007), Figueroa (1992),	Gastanaga et al. (1998), Desai et al. (2002)	Neumayer (2007),
Gross domestic Fixed capital formation		Moosa (2007)	
Research & Development			Moosa (2007)
Corruption		Drabek and Payne (1999), Kaufmann and Wei (1999), Wei (1999), Smarzynska and Wei (2000), Gastanaga et al. (1998)	Egger and Winner (2005),
Civil war		Li 2006	
Interstate war		Li (2006)	
Democracy	Kobrin (2005),	Li and Resnick (2003),	Harms and Ursprung (2002), Jensen (2003), and Busse (2004), Busse and Hefekar (2007), Li and Resnick (2003), Jakobsen and de Soysa (2006), Guerin and Manzocchi (2009), Jensen and Young (2007),
Genocide Political killings	Asiedu (2002)		
Annual number of international terrorism attacks 1990-2006	Li (2006),		

Political instability	Jaspersen et al. (2000), Loree and Guisinger (1995), Hausmann and Fernandez-Arias (2000),	Schneider and Frey (1985), Edwards (1990),	
Country Risk		Moosa (2007)	
Infrastructure developments(telephone lines			Mina (2007), Asiedu (2002),
Institutional quality			Mina (2007), Meon and Sekkat (2007), Benassy-Quere et al. (2005),
Return on Investment			Asiedu (2002)
Government Consumption to GDP	Asiedu (2002)		
The ratio of liquid liabilities to GDP	Asiedu (2002)		
European Monetary Union (EMU)			Aristotelous (2005), Foad (2006), De Sousa and Lochard (2006), Petroulas (2007), Schiavo (2007), Brouwer et al. (2008),

2.8 Summary and Conclusions

In this chapter, I have attempted to describe the important concepts of FDI, explain their motives, kinds, and existing theories. Some of these theories are still widely used in empirical studies such as Eclectic Paradigm.

Other theories are gaining more value with the change in economic and political conditions all over the world.

Chapter 3
Methodology

3.1 Introduction

In this chapter, I give a brief description of the research method used for the three quantitative analyses and consider the strengths and weaknesses of the selected approaches. This thesis analyses large country-level macroeconomic datasets over a long period of time using both pooled OLS method and panel data estimation techniques. The pooled Ordinary Least Squares (OLS) model is used in the study on the effects of currency unions and trade agreements. Since dummy variables for currency unions and trade agreements are included in the modeling, pooled OLS is preferred to fixed effect panel, as it prevents the problem of fixed effects being collinear with the dummies and thus avoids the problem of multicollinearity.

Panel data, by allowing the use of individual-specific effects, handles the issue of heterogeneity well. Panel data also gives more weightage to an empirical study as it amalgamates the information contained in both the cross-sectional and time-series dimensions, which is more realistic and augments the results of the analysis (Gujarati 2003:637-638).

3.2 Issue of Heterogenerity

Given the heterogeneity of the 180 countries how did you deal with this? Show that it is a problem; assess how important a problem it is and demonstrate how you dealt with it.

This thesis employs fixed effects panel data methods to analyze the effects of political risk on OECD countries and also to study on the determinants of FDI from the perspective of Eclectic Paradigm. The fixed effects model (country dummies) is very useful when we assume no time-specific effects and focus only on individual-specific effects (allowing each cross-sectional unit to have a different intercept) which takes care of hetereogeneity issue well (Studenmund 2011:528; Gujarati 2003).

If data measurement errors occur due to the use of poor quality data in some countries, then this problem is minimized by using GLS weights. OLS gives equal importance or weights to the observations. Therefore, we use Generalized Least Square weights, to give less weight to observations with greater variability compared to the observations with less variability. This strategy allows making use of the information contained in the unequal variability of the dependent variable (Gujarati and Porter 2008).

3.3 Limitation of fixed effects models

One of the limitations of fixed effects models is that it is not possible to evaluate the impact of variables that have little within-group variation

(variables that do not vary over time but for individuals). Fixed effects models do not include time lag effects. Errors may possibly correlate or become very low over time. In order to control the problem of omitted variable, fixed effects approach takes out all cross-section variation in the dependent and independent variables.

A solution used for the problem of large sample size and heterogeneity is that we restricted our analysis in one of the chapters to a sample of developed countries only. Data management and analysis were performed by E-views software to explore the large quantitative datasets. The first quantitative study examines the impact of regional integration activities on FDI especially from the perspective of increasing membership of trade agreements and currency unions. The analysis intends to find the effects of membership on the FDI of countries. The study uses pooled OLS method as it is more appropriate method for the analysis of dummy variables and prevents from the problem of multicolinearity.

The second and third empirical chapter uses both pooled OLS estimation and fixed effects panel data methods. The second chapter examines the impact of selected political variables on OECD countries, which represent a selective group of countries including developed and developing nations and strengthen the important impact of political factors on FDI and investors' decisions. The third and the last empirical chapter examine the impact of economic and legal origin variables from the perspective of Eclectic Paradigm. The sample selection was done very

carefully by keeping in view the importance and relevance of these economic variables to FDI on theoretical grounds.

3.4 Stationarity and its importance for variables

When a variable shows no substantial trend over time, the mean and variance of a variable is constant over time and if the simple correlation coefficient between Xt and Xt-k depends only on the length of the lag (k), the variable is said to be stationary. Unit root test is used to test the stationarity of the data.

It is very important to have stationary variables, as it is a type of series which exhibits independence. In other words, the stationary data holds similar properties as are found with independent data. Suppose that our data consists of X1,...,Xn observations and the most important assumption for the sample to have is that Xi are independent from each other and time. In other words, data is non-stationary when data exhibits a constant "upward increase (trend) as well as variability over the years" (Gujarati 2003:26). If the variables are non-stationary, the results may have the problems of autocorrelation, or problem of spurious, or nonsense regression.

Therefore, individual unit root tests Fisher-type ADF and PP tests (Maddala and Wu 1999; Choi 2001)) and joint unit root (Levin et al. 2002) panel unit root tests are conducted in political chapter to test the stationarity of foreign direct investment, net inflows as % of GDP (FDI_Inflow). The

study found that the explanatory variable was a good choice as no individual or joint unit root were found.

3.4.1 Levin, Lin and Chu test

Joint unit root tests have more power as compared to individual unit root tests. The probability of rejecting the null hypothesis (unit root) when it is false is called the power of a test. Levin-Lin-Chu test (2002) proposes the following hypothesis:

H_0 = There is a common unit root process

H_1= The data is stationary

More specifically, we want to check whether the common coefficient ρ in the equation below is equal to zero.

$$\Delta y_{it} = \rho y_{i,t-1} + \sum_{l=1}^{pi} \theta_{iL}\, \Delta y_{it-L} + d_{mt}\alpha + \varepsilon_{it}$$

In the equation d stands for exogenous variables, while α is a vector of coefficients.

Levin, Lin and Chu test is conducted in several steps. In the first step we estimate the regression given above and calculate $\hat{\sigma}_{ei}$ - the standard errors of each ADF. Secondly, we have to run the two additional regressions:

1. Δy_{it} *on* $\Delta y_{i,t-L}$ *and* d_{mt} *to obtain the residual* $\hat{e}_{it}$ *and*
2. $y_{i,t-1}$ on $\Delta y_{i,t-L}$ *and* d_{mt} *to get residuals* $\hat{v}_{i,t-1}$

In the third step, residuals are standardized by:

$$\bar{\bar{e}}_{it} = {}^{\hat{e}_{it}}/_{\hat{\sigma}_{ei}}$$

$$\bar{\bar{v}}_{i,t-1} = {}^{\hat{v}_{it-1}}/_{\hat{\sigma}_{ei}}$$

where $\hat{\sigma}_{ei}$ stands for the standard error from each ADF. In the last step, pooled OLS regression is to be run.

$$\bar{\bar{e}}_{it} = \rho\bar{\bar{v}}_{i,t-1} + \tilde{\varepsilon}_{it}$$

A modified t-statistic for the slope will be normally distributed, which facilitates the performance of the unit root test.

3.4.2 Fisher-type ADF and PP tests

Maddala and Wu (1999) suggest the use of Fisher test for the analysis of panel data unit root. The Fisher test has a big advantage in that it can be applied with any type of unit root test as it is centered around the p-value of n independent tests. In our application we combine the idea introduced by Fisher in the context of ADF and Phillips-Perron tests.

Augmented Dickey-Fuller test (ADF) is an expanded version of Dickey-Fuller test and is used to add sufficient lagged dependent variables to

get rid of the residuals of serial correlation. The formula for augmented Dickey-Fuller test is:

$$\Delta y_t = \alpha + \beta_t + \gamma y_{t-1} + \delta_1 \Delta y_{t-1} + \cdots + \delta_{\rho-1} \Delta y_{t-\rho+1} + \varepsilon_t$$

where α is a constant, β the coefficient on a time trend and ρ the lag order of the autoregressive process.

Phillips-Perron test (1988) amends t-ratio of the α coefficient in a way that the test statistics/ regression with serially-correlated errors does not need extra lags of the dependent variable for the test of unit root. This is a non-parametric test and performs better in regressions with large samples (Mahadeva and Robinson 2004).

$$\tilde{t}_\alpha = t_\alpha \left(\frac{\gamma_0}{f_0}\right)^{\frac{1}{2}} - \frac{T(f_0 - \gamma_0)(se(\widehat{\alpha}))}{2 f_0^{1/2} s}$$

Both ADF and PP tests can be used for each cross-sectional units of the panel and aggregated in the Fisher test. The method for Fisher test uses chi-square distribution with 2*N degrees of freedom, N stands for the number of individual tests. The Fisher test is contingent on the assumption of independence. The distribution of the Fisher test becomes unknown when correlation among variables is found. In that situation, Maddala and Wu (1999) propose regressing the variable under the null hypothesis and bootstrapping across the cross section residuals for each t. For the purpose of bootstrapping, it is important that the residuals of the regression are not auto-correlated. The formula for Maddala and Wu (1999) is given below:

$$P_{MW} = -2\sum_{i=1}^{N} \log(pi)$$

Like Maddala and Wu (1999), Choi (2001) test also uses fisher test for the analysis of unit root using p value combination tests. Standardized statistic formula for Choi (2001) is:

$$Z = \frac{\sum_{i=1}^{N} \Phi^{-1}(p_i)}{\sqrt{N}}$$

3.5 Hausman's test (1978)

The Hausman specification test is widely used to compare and analyse whether to use fixed effects or random effects approach for the study. This test examines whether the regressors are correlated with unique errors. If the null hypothesis is true and p-value is significant then fixed effects method is used. But in case, the null hypothesis is found insignificant, then random effects method is applied to the study.

$$H = (b - \beta)'\big(Var(b) - Var(\beta)\big)^{-1}(b - \beta)$$

Where b are the estimated coefficients from a fixed effect panel, while β are the estimates from the random effect panel. In our study we expect a priori that a fixed effect panel will fit the data better, as the differences between countries are non-random and rather structural in nature.

3.6 F-Test

This study employs F-test to examine the joint significance of the regression which shows that all slope coefficients are equal to zero at the same time (Gujarati 2003).

The formula for F-test is given below;

$$F = \frac{ESS/df}{RSS/df} = \frac{ESS/(K-1)}{RSS/(n-k)}$$

Where ESS stands for explained sum of squares and RSS denotes residual sum of squares. (Gujarati and Porter 2008)

3.7 Why a dynamic panel data approach was not used

Dynamic models are those models which represent the time path of the dependent variable in relation to its past values (Gujarati and Porter 2008). These models contain lagged dependent variables, allowing for the modeling of a partial adjustment mechanism.

This study do not uses dynamic panel approach, because when accounting for unobserved heterogeneity, the methods for modeling this are limited. And the fixed effects solve the problem of unobserved heterogeneity well.

Another important reason is that dynamic panel data method has a problem of weak instruments. When the instruments are weak, different

problems arise such as bias of 2SLS estimator with non-normal distribution and poor performance of Wald test (Bun and Windmeijer 2007). Secondly, the choice of instruments is often arbitrary, which allows the researcher to manipulate results. Many earlier papers (Agiomirgianakis et al. 2004; Asiedu 2006) used exactly the same modelling approach as I have - a fixed effect panel. Basing on this I am trying to add to the existing knowledge.

Chapter 4
The Effects of Currency Unions and Trade Agreements on Foreign Direct Investment (FDI) Movement

In the recent years, there has been a rise in regional integration activities such as membership of currency unions and regional agreements. The reasons for regional integration agreements may be both economic and political. These integration activities are likely to have large effects on investments between the regions. Therefore, it becomes an important issue to find out how the membership in Currency Unions (CUs) and Regional Trade Agreements (RTAs) could affect inward and outward investments. Limited literature is available on the effects of currency unions and regional agreements on FDI. This chapter aims to examine the effects of currency unions and trade agreements on inflows, outflows and net FDI of different countries. For this purpose, I undertake an empirical investigation of the relevant factors that determine the effects of the membership of CUs and RTAs on FDI and use pooled OLS estimation method for 180 countries over the period 1970-2007. My sample consists of 5 currency unions and 10 trade

agreements. The study finds mixed results for CUs and Regional Trade Agreements (RTAs). The empirical findings indicate East Caribbean Currency Area (ECCA) and Economic and Monetary Community of Central Africa (CEMAC) membership increases net FDI of countries. Among different RTAs, Andean Community (CAN) and Mercosur boost net FDI of the members. The regression analysis shows that membership of WTO is significant and robust in all the regressions: inflows, outflows and net FDI. The membership in EU and Eurozone increases both FDI inflows and outflows, with the raise being more significant for the latter.

4.1 Introduction

There has been a growth in regional integration activities worldwide in the recent years. Nowadays, increasing number of countries are inclined towards the use of a single currency due to international economic integration. For instance, Gulf Cooperation Council (GCC) countries are still in the process of assessing the feasibility of a single currency for the Gulf region. The number of countries which use Euro has increased from 11 in 1999 to 17 in 2011 out of 27 members of the European Union. Other currency unions namely Economic and Monetary Community of Central Africa (CEMAC), West African Economic and Monetary Union (WAEMU) and East Caribbean Currency Area (ECCA) are also examples of countries from the same region using the same currency for economic reasons. Dollarization has

been a much discussed issue, as some countries use dollar as their currency, irrespective of what region they belong to (e.g. Panama).

It seems that more countries are assessing or measuring the positive impact of Currency Union (CU) membership to avail the benefits of CU. This study has the potential to provide answers to the countries that seek to obtain maximum advantages from the membership of a CU and illustrates how joining a currency union may influence their inflows, outflows and net FDI. Further, there has been an on-going debate about the impact of regional trade agreements on trade, but there is a notable lack of attention towards the impact of regional trade agreements on FDI. Almost all of the countries have joined regional agreements for their political or economic survival. So it becomes essential to investigate the consequences of these important decisions.

The chapter is organised as follows. Section 2 reviews the proposed theoretical framework of currency unions and their impact on FDI. Section 3 focuses on regional trade agreements and the economic effects of regional trade agreements. Section 4 describes the explanatory variables used in this study. Methodology and data for the study are explained in section 5. In section 6 I present results. Finally, section 7 offers some concluding remarks.

4.2 Currency Unions (CU)

Currency union (also called monetary union) is a union where one or more countries decide to adopt the currency of another country as their own legal tender (e.g. dollar) or countries decide to use a single currency mutually for some political and economic reasons (e.g. Euro). It is observed that countries join a currency union or adopt other country's currency for the benefit and stability of their country. One of the fundamental reasons to join currency unions includes the need or motivation to keep inflation under control (Silva and Tenreyro 2010; Frankel and Rose 2002; Agenor 1994), which is a burning issue for many nations. The use of common currency gives stability to the currency of a country, as the union then takes the responsibility for the monetary policy and stability of a country in terms of inflationary control. Another important motive is to avail the benefits of economic integration. It facilitates transfer of factors of production and helps in elimination of trade barriers, which in turn makes trade attractive for the member countries. Further, common currency helps to eliminate the problems of exchange rate fluctuations and different currency rates, which promotes trade and investment within currency union (Silva and Tenreyro 2010; Alesina and Barro 2002; Ng 2002; Fielding and Shields 2003).

Countries have a tendency to be more inclined towards joining currency unions, as one of the benefits of currency unions is that the membership assists to shrink or eliminate transaction costs of trade, which supports openness and increases trade and investment among the member

countries of the currency union (Ng 2002). Frankel and Rose (2002) find evidence that a country's income increases due to raise in trade caused by membership of currency union and that otherwise there is no direct relationship between currency union and income. However, Dwane et al. (2010) find contrasting results with no direct relationship between trade and European Monetary Union (EMU), although a very strong impact of UK-Ireland currency union on the trade of Ireland was observed.

In the process of switching from a country's individual independent currency to a mutually agreed currency, a country has to sacrifice her control over monetary policy through which it could take necessary measures to improve its economic conditions (Silva and Tenreyro 2010; Ng 2002). Member countries then become dependent and compelled to follow the policies issued by currency board or central banks of currency union for their monetary policy, irrespective of their dissimilar economic opportunities and threats (Alesina and Barro 2002; Ng 2002). The situation becomes worse in a case when the currency union countries face unrelated economic shocks (Frankel and Rose 2002). There are some members of European Community, that is the United Kingdom, Latvia, Denmark, Lithuania, Hungary, Poland, Romania, Czech Republic and Sweden which still use their own currency in order to retain the freedom regarding monetary policy matters and are in the process of assessing the pros and cons of using the Euro.

4.2.1 Optimum Currency Area (OCA) Theory

In his seminal work, Robert Mundell (1961) presented a path-breaking theory about currency unions and currency areas and discussed the criteria for a feasible working system of currency areas and unions. These criteria were labor mobility, the degree of wage flexibility and free capital movement. When discussing the adjustment mechanism of macroeconomic asymmetric shocks among currency union countries, Mundell (1961) had given more emphasis on the factor (labor and capital) mobility in comparison to real exchange rate flexibility. In a situation of insufficient real exchange rate flexibility and factor of production mobility, countries face the problems of increased unemployment. According to Mundell's theory (1961), states can acquire the benefits of membership of currency union through the elimination of exchange rate variability and lower transaction costs. The suitability of membership of currency union is evident from the degree of losses which are contingent on the nature of macroeconomic symmetric or asymmetric shocks and the speed of adjustment of nations.

Mundell's work is divided into two different view/ models. In his earlier work, Mundell (1961) suggested that smaller currency areas should be formed instead of making a large common monetary/ currency area to effectively deal with the problems of individual country disturbances. On the other hand, in a later model of Mundell, he supported the common currency union among the diverse nations facing different economic disturbances.

When we discuss the effects of fixed exchange rates, inflexible prices and wages negatively affect the terms of trade from performing their crucial part in the adjustment process. Episodic balance-of-payments crises play and will keep playing a very crucial role in international economic systems. Common currency areas of Eurozone are affected by balance of payments crisis and it is said to have started around 2007 (Sinn 2012).

McKinnon (1963) on the other hand, associate the advantages of membership of currency union with trade liberalization due to decrease in transaction cost resulting in an increase in trade among members. Kenen (1969) suggested that the economic diversification should be used as an important indicator of the suitability of currency areas as the countries with low degree of economic diversification are prone to encounter/ suffer asymmetric shocks for which the independent exchange rates are preferred. The countries which face asymmetric shocks and have poor factor mobility (i.e. labor and capital) are not suitable candidates for the membership in currency unions (Bayoumi and Eichengreen 1994). The similar situation takes place in the case of highly diversified economies/ which face symmetric economic shocks/nature of disturbances. These countries have the advantages of following uniform policies with the countries facing similar problems. The economic condition of countries facing high inflation (asymmetrically distributed aggregate demand shocks) may be related to their domestic policy.

Bayoumi and Eichengreen (1994) have analysed the countries experiencing similar economic disturbances/ shocks by looking at their demand and supply shocks incidents and concluded that high degree of specialization is likely to be associated with asymmetric shocks and with floating exchange rates between separate currencies.

In 1960s, floating exchange rate or external exchange rate flexibility was considered/ referred to have an independent monetary policy in terms of the adjustment of macroeconomic shocks in individual countries by (McKinnon 2000). However, there is a change of direction in 1970s Mundell's later work, where he support/approve the concept of membership of currency unions by looking at the impact of future exchange rate uncertainty on capital markets (keeping in view the international portfolio diversification and risk sharing). The later study of Mundell suggests that countries can better cope with asymmetric shocks by having better reserve pooling and portfolio diversification (McKinnon 2000:313).

4.2.2 Economic Effects of Currency Union

Most of the earlier literature is available on the relationship between trade and currency unions (Brouwer et al. 2008; Rose and Van Wincoop 2001; Rose and Engel 2002; Frankel and Rose 2002; Tenreyro and Barro 2003; Rose 2000; Nitsch 2002; Micco et al. 2003; Dwane et al. 2010; Bun and Klaassen 2007). However, only limited literature describing the effects of currency unions on FDI is available**.** There are the studies which examine the

effects of EMU on the member countries (Aristotelous 2005; Schiavo 2007; Foad 2006; Brouwer et al. 2008; De Sousa and Lochard 2006; Petroulas 2007). Edwards and Magendzo (2003) draw a distinction between the economic performance of currency union countries with the countries having own currencies and classify currency union countries into independent currency union and dollarized countries. Edwards and Magendzo (2003) found that membership in currency unions is beneficial for a country's economic growth and monetary policy. Both independent currency union and dollarized countries have higher growth volatility and lower rate of inflation than countries with their own currencies.

Rose and Engel (2002) found membership in currency union allows countries to reap the benefits of higher international integration (more trade), lower rate of inflation and highly synchronized business cycles compared to countries with their own currencies. They find that member countries are smaller in size, more open to international trade and capital investments. However, Rose and Engel (2002) data does not include European Economic and Monetary Union (EMU). Glick and Rose (2002) examine the time series effect of joining or leaving a currency union on international (bilateral) trade using panel data set for over 200 countries from 1948 to 1997. Glick and Rose (2002) found that bilateral trade nearly doubled when countries joined currency union and halved when they left currency union. Their study does not include the European Economic and Monetary Union (EMU).

Rose (2000) uses gravity model and panel data set to analyse the impact of common currency and exchange rate volatility on international trade for 186 countries from 1970-1990. He finds that joining common currency union increases international trade three times among the member countries and the volatility of exchange rate has small negative effect on international trade. Frankel and Rose (2002) investigate the effects of membership of currency unions on income and trade of a country and suggest that joining currency union increases bilateral trade within member countries and does not have any diversion effect on trade of non-member countries. However, membership has indirect positive effect on income of a currency union country.

This study includes four monetary unions (which have a common central bank) i.e. Economic and Monetary Community of Central Africa (CEMAC), East Caribbean Currency Area (ECCA), West African Economic and Monetary Union (WAEMU), European Monetary Union (EMU) and Dollarized countries (with no common monetary institution controlling monetary policy of dollar using countries). The important question is whether membership of currency unions is beneficial for countries? Which of the currency unions are most efficient in achieving the desired effects?

4.3 Regional Trade Agreements and their Economic Effects

There has been an increase in regional integration activities in recent years such as European Union (EU), (Southern Common Market) MERCOSUR, etc. Countries seek regional trade agreements for various reasons. For instance, a country may adopt a regional trade agreement to gain access to large markets, increase negotiating power with third countries, consolidate national policy reforms, strengthen national security or pursue political objectives (Whalley 1998). Countries enter into RTAs to gain the benefits of international trade, but this has implicit effects on international direct investment as well (Kubny et al. 2008; Venables 1999; Brenton et al. 1999). It is due to reduced or eliminated trade barriers and constraints in an effort to promote and protect investments (UNCTAD 2009). Worth (2002:79) describes:

> *"One of the few theories developed about RTA's and FDI predicts that an RTA should increase FDI into the integrated area as firms seek to take advantage of an expanded market now able to support projects with larger fixed costs."*

The main motive to join RTAs is to gain long-term and short-term economic advantages for the country. Long-term advantages may for instance include access to larger markets which toughens competition, increases effectiveness and large scale production (Jaumotte 2004); short-term advantages may include boosting an intra-regional trade and investments due to reduced or eliminated trade barriers and restrictions, both supposed to

benefit the economic condition of a country (Blomstrom and Koko 1997) and inflict unified trade barriers on other countries (Jaumotte 2004). The differing effects of RTAs on FDI into or out of member countries are subject to the host and home country features. Home country characteristics depend on the kind of motives of FDI (whether FDI is tax-induced, resource-seeking, asset-seeking, market-seeking or efficiency-seeking) and source of FDI (member or non-member country) (Kubny et al. 2008).

Blomstrom and Koko (1997) measure the differing effects of joining Regional Integration Agreements (RIAs) according to size, competitiveness and trade and investment patterns of each country. For instance, the countries with large FDI outflows are less likely to be affected than the countries with large FDI inflows. Like advantages, there are some disadvantages, such as allowing the products from members' inefficient industries, which at times become the reason of failure of RIAs (Pompret 2006).

There are two kinds of opinions that developed for the FDI motives. According to the early literature, FDI and trade were considered substitute for each other, as it was believed that trade flourishes and FDI decreases in those countries which have minimum or no restriction and trade barriers; FDI grows and trade shrinks when trade barriers and restrictions tightens. On the other hand, recent literature supports the opinion that the presence or absence of trade barriers or tariffs may not have much influence on market-seeking FDI (Milberg 1999; Blomstrom and Koko 1997), because foreign investment occur in order to avoid transaction costs and exploit the intangible assets.

Utilization of intangible assets such as brand recognition, business methodologies, intellectual capital and better marketing skills, better technology by foreign investors is regarded the main reason for FDIs to take place (Blomstrom and Koko 1997). Intangible asset motivated or market-seeking FDI is not supposed to decrease when tariffs are minimized (Jaumotte 2004).

Among three modes of market entry (exports, licensing and FDI), foreign investors prefer FDI on the basis of competitive advantage in comparison to the local businesses (Sinha 2010). Local businesses usually have some gifted advantages, such as better knowledge of market, consumer preferences and established channels of distribution (Rarick 2004), which are difficult and costly for foreign businesses to challenge. However, businesses invest in foreign countries to exploit their intangible assets and to keep business secrets with them, as exports involve the cost of transportation and licensing involves higher transaction costs and sharing valuable business information. (Blomstrom and Koko 1997; Daniels et al. 2004). Businesses also undertake FDI to acquire those intangible assets which they lack, such as advertising and research and development (Blonigen 2005). Therefore, FDI is likely to happen even in the absence of trade restrictions and barriers among countries.

Tariff-jumping FDI is expected to decrease due to reduced trade barriers and openness of trade when the degree of regional integration increases among the countries making trade an economical option for

investors (Te Velde and Bezemer 2006; Jaumotte 2004). Blomstrom and Kokko (1997) assert that intra-regional FDI may increase in some cases, but the overall effect of regional agreement is likely to be negative. However, Jaumotte (2004:3) describes that interregional FDI is expected to increase with the increase in RTAs and for intra-regional FDI, the impact of RTAs is vague due to the "the structure and motives for pre-existing investment". He asserts that interregional FDI inflows increase in a country that has larger markets. The firms from countries that are not members of the same region that benefit most are those whose competitiveness is the result of research and development costs. Another reason for the increase of interregional FDI is when the regional agreements of a particular region increase common trade barriers for the outsiders. However, RTAs bring intra-regional tariffs to an end, which increases vertical intra-regional FDI due to location advantages and reduced trade costs; result in increase in exports, and a chain of international businesses and Multinational Corporations (MNCs) within the whole region (Jaumotte 2004; Te Velde and Bezemer 2006; Motta and Norman 1996).

On the whole, RTAs increase FDI; nonetheless not all the countries involved in regional agreements receive this benefit. Foreign investment usually concentrates in a few countries with location advantages among the regional members indicating the decrease of FDI for member countries lacking location advantage (Kubny et al. 2008; Jaumotte 2004). Kubny et al.

(2008) asserts that size or economic well-being a country may not have greater influence on FDI inflows with regard to RTA membership.

The reason to conduct this study is to find out why certain territories gain more share of FDI than others. Is it more beneficial for some countries to become part of one RTA than others from the viewpoint of FDI? What effects do regional trade agreements have on FDI? There seems to be scarce literature on the effects of different RTAs on FDI.

Yeyati et al. (2003) examine the impact of regional agreements on bilateral OFDI stock using gravity model and find membership of Free Trade Agreement (FTA) has positive and highly significant effect on bilateral OFDI stock. They find that membership almost doubles bilateral FDI.

Te Velde and Bezemer (2006) study the impact of regional trade agreements on FDI inflows for the period of 1980-2002. Their study included variables for the regional agreements: SADC, COMESA, CARICOM, ASEAN, ANDEAN, NAFTA and MERCOSUR.

4.4 The Determinants of FDI/ The Description of Explanatory Variables

The brief description of macroeconomic variables used in this study is given below:

4.4.1 Market Growth

The growth in the market size gives a significant idea of the expected demand and profits for investors. The rise in GDP triggers investments, which results in increased production, employment, consumption, product demand and revenues for investors. This helps organizations to gain more profits and benefits from economies of scale and scope and suggests that the annual change or increase in economic growth will attract market-oriented foreign investment into the country (Buckley et al. 2007). Market growth is measured in terms of rate of annual percentage change of GDP at market prices based on constant local currency. GDP growth is reported to have positive and significant impact on the FDI inflows in investment literature studies. The GDP growth rate is selected as a variable for the study for the reason that FDI is a long term investment and GDP growth rate gives a good estimate of countries' economic condition in the long run (Jaumotte 2004).

4.4.2 Inflation

Inflation is an important economic factor. High inflation is considered as an indicator of macroeconomic instability, as it might lead to devaluation of currency, which reduces the value of real earnings and purchasing power within the host country for investors and makes (market-seeking and export oriented) investments unattractive in the host country. It affects the interest rates and makes borrowing of funds costly (Daniels et al. 2009). Unstable

inflation rates reduce the faith of investors and market-seeking FDI, as it becomes tricky to make long-term goals and policy decisions regarding pricing strategies and operating profits. Therefore, for FDI inflows, the coefficient on inflation is assumed to be negative (Buckley et al. 2007; Dhakal et. al 2007; Schneider and Frey 1985).

4.4.3 Openness

FDI and trade have a much debated relationship, whether they complement or substitute each other. In any way, trade liberalization is considered to have a significant impact on FDI, as government trade liberalization policies make business environment conducive to foreign investments and foreign investors are more attracted towards a host country which has minimum or no capital control and investment-friendly procedures (Taylor 2000). The more open an economy is, the more one would expect export-oriented FDI to increase. However, tariff-jumping FDI will increase, if more trade restrictions (less trade liberalization) are imposed (Asiedu 2002). Openness is extremely significant factor in terms of RTAs. The same applies to home country investors; as such conducive investment climate and policies create more competition within the home country and are supposed to stimulate FDI outflows from a country to challenge the rivals in their markets. Therefore, openness is supposed to increase both FDI inflows and outflows.

4.4.4 Real Interest Rate

Interest rate is the monetary policy instrument which is used to control money supply in a country. Higher interest rate implies the scarcity of capital, increasing the opportunity cost of capital, making direct investment in and out of country costly. On the other hand, lower interest rate, demonstrates the availability of ample capital for investment purposes, may increase the FDI outflows from the country (Kyrkilis and Pantelidis 2003; Tolentino 2010). Interest rate is expected to have a negative relationship with FDI.

4.4.5 Current Account

Current account is the measure of strength and stability of a country's currency. Current account deficit is believed to depreciate the currency of a country which increases inflation and causes exchange rate fluctuations. This situation might affect the capital flows as foreign investors lose their confidence to make a long term investment in the country (Dhakal et. al 2007). This in turn may reduce the value of the assets and discourage the prospective investors from the country. On the other hand, current account surplus stimulate outward investment. The current account as a percentage of GDP is selected to examine the impact of current account on inflows, outflows and net FDI of countries. Schneider and Frey (1985) in their study,

found a highly significant impact of current account deficit on FDI inflows showing that lower current account deficits increase FDI inflows.

4.4.6 Real GDP per Worker

Real GDP per worker is the inflation-adjusted GDP per worker of a country. The variable is an indicator of the potential productivity increases or decreases per worker in an economy. This variable is used to find the relationship between the labour productivity and FDI of a country. Real GDP per worker is assumed to have positive impact on inflows, outflows and net FDI of a country and measures the ability of countries to produce the outputs.

4.4.7 European Monetary Union (EMU)

The currency of Euro was officially introduced on 1st January 1999. The membership of EMU expanded from 11 to 17 EU member countries within twelve years. Euro was expected to increase trade and investment within the region with a common currency to support the further economic and political integration of the region. Aristotelous (2005) examine 15 European Union countries from 1966-2003 and find positive and significant impact of EMU on US FDI flows into Euro zone. Foad (2006) argue that due to creation of Euro, US FDI decreased in United Kingdom, Sweden and Denmark and increased in Euro countries.

De Sousa and Lochard (2006) used gravity model and report an increase of FDI inflows within the Euro-member countries. Petroulas (2007) document statistically significant and positive effects of EMU on FDI inflows into Euro zone with 16% increase in FDI among euro countries, 11% increase in FDI outflows and 8% increase in FDI inflows in Euro countries from non-member countries. Schiavo (2007) examines the data for 25 countries from 1980-2001 and reports that euro increases FDI flows by approximately 100% between member and non-member countries and above 200% between member countries. Schiavo (2007) studied the impact of Euro on member countries' FDI and report positive impact of membership. Brouwer et al. (2008) study the impact of membership on FDI inflows of Eurozone countries and find 21% increase among euro countries, 129% between existing and new member countries. Bergsten (2010) calls EMU a work in progress, which needs to develop in order to fulfil the expectations.

4.4.8 Central African Economic and Monetary Community (CEMAC) and West African Economic and Monetary Union (WAEMU)

CEMAC and WAEMU are considered a unique kind of monetary unions, because although they have different central banks with distinct currencies, they also have certain similarities, such as pegging their currencies with French Franc earlier and now with Euro. Both are collectively called CFA Franc Zone, both have convertibility of currency guaranteed by France and are associated with successful

systems/supranational central banks established in 1948 with stable peg levels due to "stronger institutions and more policy transparency" (Gulde 2008:3; Boughton 1991). The CFA Franc Zone has the advantage of private funds moving freely in the entire zone (Boughton 1991), especially due to the fact that there are no restrictions on investments in WAEMU (Guilde 2008).

CFA Franc Zone came into existence when West and Central African member countries were French colonies. France established two banks to manage monetary system in all African colonies, which now called as Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) for WAEMU and Banque Centrale des Etats de l'Afrique Centrale (BEAC) for CEMAC. Same currency unions operated under the supervision of France after independence, however, in the late 1970s the power was transferred to African Banks. WAEMU was established in 1994 and consists of eight members: Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo. CEMAC has six members: Cameroon, The Central African Republic, Chad, The Republic of Congo, Equatorial Guinea and Gabon (United Nations 1999; Gulde 2008; Gurtner 1999). The interesting fact is that both the currencies of WAEMU and CEMAC are convertible to Euro, but not to each other. Only central banks are allowed to exchange one CFA Franc into other CFA Franc with some tax rate (Fielding and Shields 2005). CFA Franc zone consists of both developing and under-developed countries (Gulde 2008).

4.4.9 DOLLARIZATION

It is generally known that countries adopt dollar to cope with the problem of inflation. However, Duffy et al. (2006:2074) associate dollarization of countries with "underdevelopment of financial systems", which causes inflation and faces countries to dollarize. In this study, I have taken those countries where official or full dollarization took place (i.e. when the government replaces their national currency with a hard foreign currency for instance dollar as a legal tender). Dollarized countries have a diverse position in the world as where they all use dollar in isolation and it does not make them connected or integrated with other dollarized economies. They have a different reason for dollarization and they all are small countries by population size (Fabris 2009).

Dollarization is not strictly considered a monetary union, because dollarized countries do not have a common central bank controlling the monetary policy for dollarized countries since a country adopts the currency of other country (Fabris 2009; Gulde 2008). Bahamas and Panama are the best examples of fully dollarized countries, which do not have their discrete national currencies (Fielding and Shields 2005). However, dollarized countries lose the seigniorage gain, which remains in the US. Hanke and Schuler (1999) advocate dollarization for countries and reason that a country can non-dollarize without much problem when adopted unilaterally in comparison to other currency unions. However, dollarization in a way may be beneficial for the countries, as the economic conditions of the nation become

stable (stable exchange rate, lower interest rates and lower inflation) and it becomes more acceptable in the world (Hanke and Schuler 1999; Kim and Mah 2007; for detailed advantages and disadvantages of Dollarization see Fabris 2009). Kim and Mah (2007) examine the economic condition of Ecuador and El Salvador after dollarization and conclude that the effects of dollarization differ between countries depending on their objectives. They find that Ecuador dollarized for economic development, its FDI inflows increased; however, El Salvador's objective for dollarization was political, and hence no significant effect on FDI was observed[1].

4.4.10 Eastern Caribbean Currency Union (ECCU)

The Eastern Caribbean Currency Union (ECCU) comprises of eight island countries: Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines. Eastern Caribbean Central Bank controls the monetary policy of ECCU and issue the ECCU Dollar which is pegged to the US Dollar at a fixed rate[2]. US Dollar is also accepted and used for transactions within the ECCU countries due to the proximity and considerable tourism, however, the main currency used is ECCU Dollar (Fielding and Shields 2005). The association of Caribbean countries with the US Dollar dates back to 1960s and 1970s, when most of these British colonies got independence and their currencies were

[1] Palau, Marshall Islands and Fed. States of Micronesia, were not included in the sample.
[2] Anguilla and Montserrat are not included in the sample because of the unavailability of FDI data.

pegged to US dollar, due to devaluation of sterling against dollar (Worrell 2003).

4.4.11 MERCOSUR

Four Latin American countries, Argentina, the Federative Republic of Brazil, Paraguay and the Eastern Republic of Uruguay signed an agreement in 1991 to form a southern common market for political and economic purposes. Mercosur is believed to be a success among the other Latin American agreements (Malamud 2004). Mercosur had robust positive impact on the FDI inflows in the member countries especially in Argentina and Brazil where foreign investment increased (Jaumotte 2004). The reasons for the expansion of investments may be the considerable liberalization policies, economic development and privatization arrangements taking place in both the countries at that time (UNCTAD 2009; Kubny et al. 2008; Jaumotte 2004). Baer et al. (2002) associate increase in FDI inflows with the replacement or decrease in bilateral trade among Mercosur members due to lack of macroeconomic coordination and divergent economic priorities of the two major economies of Mercosur.

Kubny et al. (2008) investigates four case studies of integration agreements i.e. Mercosur, ASEAN, SAARC and SADC and find evidence that country-specific factors have more influence on FDI than RTAs. Jaumotte (2004) argues that FDI increased approximately 33 percent in RTA countries over non-RTA countries in 1990s. The FDI inflows increased

robustly in the member countries. Mercosur's intra-regional trade increased threefold in member countries and so did the inter-regional trade within the time of 10 years of Mercosur (Malamud 2004).

4.4.12 European Union

The European Union (EU) is a group of leading, highly developed and technologically advanced countries with a record of significant achievements over a long time and substantial effects on FDI. It consists of both supranational and inter-governmental multi-level governance (Malamud 2004). Its history dates back to the origin of European Economic Community (EEC), which was set up in 1957 by six countries i.e. Germany, France, Italy, the Netherlands, Belgium and Luxembourg in order to eliminate customs barriers among the members and to impose common duties on imports from non-member countries (Dedman 2010). EU was established in 1993 out of the experience of EC (Gleason 2003).

Further, the creation of Single European Market (SEM) proved a successful step towards market liberalization to form a common market for the member countries for the free movement of factors of production such as labour, goods and services (Europa 2011), which increased the intra-EU FDI. There was a rise from 26 per cent to 48 per cent in total world FDI inflows to EU within mid-1980s to early 1990s, especially from Japan and Korea (UNCTAD 2009). The EU membership has become so beneficial that FDI inflows increased in accession countries before and after membership.

European Union membership has a positive and significant effect on FDI (Buch and Piazolo 2001; UNCTAD 2009). Buch and Piazolo (2001) found mixed results for the effects of EU membership on the countries (in the process of EU accession). They found that EU accession has close to expected levels of increase in FDI in three countries, i.e., the Czech Republic, Hungary, and Poland. Buch and Piazolo (2001) report likely increase in FDI in accession countries from other member countries and diversion of trade in terms of imports from member states. The EU membership requires the candidate states to follow the rules and regulations of EU and to increase openness with all EU countries in terms of trade and investment (Buch and Piazolo 2001).

Flam (2009) gives an example of FDI increase in Ireland, where multinationals were seeking to gain access to EU markets. Shin (1998) supports the view that FDI proved a substitute to Korean electronics exports, as Korean FDI in electronics increased in EU substantially due to a variety of trade and non-trade barriers (i.e. export volume control and anti-dumping duties, tariffs and quotas).

Brouwer, et al. (2008) conducted panel data study on ten countries from 1990-2004 which became European Union members in 2004 and found positive impact on FDI and trade. Motta and Norman (1996) study the impact of membership of EU, NAFTA and ASEAN on FDI and found that UK acquired big share of FDI by emphasizing on EU to minimize the intra-regional trade barriers which stimulate intra-regional export-platform FDI to

increase within a regional area. They found that belonging to a regional group increases the market accessibility within that region for potential foreign investors. Balasubramanyam et al. (2002) analyse the impact of EU and NAFTA on FDI using the gravity model and found macroeconomic factors affect the bilateral FDI not the RIAs.

4.4.13 World Trade Organization (WTO)

World Trade Organization (WTO) was established in 1995 as an international organization with the main objective of increasing world trade by enforcing member countries to liberalize their economy for trade (World Trade Organization 2011). When a country is member to WTO, the FDI inflows to the country tend to increase. WTO membership is known to put a ceiling on the trade barriers imposed by member countries. In order to become a member, a country needs to liberalize its economy for international trade, which makes a nation more open to international businesses. WTO does not exactly fall into the category of regional investment agreements, since it is related with global integration (Daniels et al. 2009). I construct a WTO dummy variable, as WTO has important effects on the economy of the member countries through dispute settlement systems, encouraging the formation of market oriented institutions and regulatory policies to increase trade. WTO trade rules play a significant role in the development of trade agreements among nations (Tortian 2007). Further, there has been significant

rise in the membership of different RTAs after the formation of WTO (Celli et al. 2011).

4.4.14 The Central American Common Market (CACM)

The Central American Common Market was created in 1960 by El Salvador, Guatemala, Honduras and Nicaragua with the main purpose of promoting and bringing industrialization within the region to gain the maximum advantages of integration for the whole region. Costa Rica joined in 1963. There were ups and downs in the performance of CACM, as it worked well for the first five years (only 10 percent intra-regional trade had customs duties) (Mace 1988). However, CACM faced problems in the second phase of regional integration, because of the imperfection in the integration process and absence of supranational institutions to implement the required measures. It was identified in the start that the trade liberalization would not benefit all members equally. Less developed countries (LDCs) in the region would suffer, as a consequence if proper measures were not taken. For this reason, it was decided that members would be stimulated to promote regional business and investments in the Less Developed Countries (LDCs) in order to support the speedy industrialization, so that LDCs gain the maximum benefits of trade liberalization. However, intended measures which could route the FDI to LDCs could not be implemented and developing countries, such as Argentina and Brazil attracted most of the foreign investments (Mace 1988). The CACM was revived in 1990s.

4.4.15 The Andean Community (CAN)

The Andean Community (Comunidad Andina in Spanish) was established in 1969, as a result of collaboration of five South American countries; Bolivia, Chile, Columbia, Ecuador and Peru joining hands together for the development of the region through integration. The Andean Community of Nations (CAN) had an advantage in that it was shaped with the knowledge arising from the experience of the failure of first phase of regional integration, such as LAFTA and CACM. Therefore, CAN was not just limited to economic transactions among the members, but it included environmental, political and demographic integration in terms of dealing with social, cultural, educational and employment issues.

It consists of supranational institutions, such as councils of presidents, foreign affairs, community court of justice, health, business and labor advisory council etc. No member government can influence the decisions of CAN. To overcome the main problem (that less developed member countries should also get a fair share of regional investments) faced by CACM in the first phase, "industrial rationalization and sectoral industrial planning" were designed along with other such programs for less developed countries (Mace 1988: 415). To accomplish the trade liberalization, it was decided that national tariffs will be reduced by 10 per cent each year in order to make CAN a free trade area gradually, which was finally achieved in 2006. CAN is now a common market.

4.4.16 Caribbean Community (CARICOM)

In an effort to bring regional integration into action in the Caribbean countries, Caribbean Community was set up in 1973. The development of Caribbean Free Trade Association (CARIFTA) corroborated the establishment of Caribbean Community and Common Market (Caricom) as a second step to regional integration, because the formation of CARIFTA brought together the Caribbean countries. With the establishment of single market, Caribbean Community intends to improve the living standards and develop the economic conditions of the member countries (Caribbean Community Secretariat 2009).

4.4.17 East African Community (EAC)

The East African Community was established in 2000 by three countries (Republic of Kenya, Tanzania and Uganda) and was later on joined by Rwanda and Burundi in 2007. EAC is considered to be the renewal of East African Cooperation (1967-1977) (East African Community Portal 2011; Katembo 2008). The fundamental objectives of EAC include the development and consolidation of regional economic, cultural and political integration of the members (Katembo 2008). EAC is an intergovernmental organization with the goal of integrating the whole region into monetary and political union.

4.4.18 Eurasian Economic Community (EAEC)

Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan signed the Eurasian Economic Community (EAEC) agreement in October 2000 with the purpose of policy harmonization within the Eurasian region and in order to eliminate the disputes over visas, trade and non-trade policies, as well as to facilitate the regional trade and investments. The EAEC agreement is expected to help the region integrate after the collapse of Union of Soviet Socialist Republics (USSR), which brought negative effects on the regional trade and made it difficult to achieve the group benefits for Commonwealth of Independent States (CIS) countries (Gleason 2003).

4.4.19 Gulf Cooperation Council (GCC)

In May 1981, six Arab states of the Gulf: the United Arab Emirates, State of Bahrain, Kingdom of Saudi Arabia, Sultanate of Oman, State of Qatar and State of Kuwait signed the agreement to increase integration and cooperation in all the areas within the GCC countries, which share the same culture and religion[3]. Its main purpose is to coordinate the rules and regulations in the areas such as economy, trade, businesses and investments, environmental resources, to achieve the goal of free movement of factors of production and ultimately move to the state of political and monetary union.

[3] Qatar and United Arab Emirates are not included in the sample due to unavailability of FDI data.

4.4.20 Southern African Customs Union (SACU)

The Southern African Customs Union was set up in 1910 and is one of the long-standing customs union or single market (Goldstein 2004). Its member countries include South Africa, Lesotho, Namibia, Botswana and Swaziland. The old SACU agreement came to halt. The new Southern African Customs Union agreement in 2002 is the revival of old SACU (Kirk and Stern 2005). SACU has achieved success among other RTAs in eliminating tariffs on intra-regional trade (Yang and Gupta 2007).

4.5 Empirical Model Specification and Data Description

In this chapter, I aim to assess the effects of currency unions and trade agreements on FDI of a country. I analyse inward, outward and net foreign direct investment (inflow-outflow) as a percentage of GDP. The reason why the dependent variables and some of the control variables are expressed as a percentage of GDP is the need to deflate and detrend the variables. I focus on the sample of panel data on 180 countries and a long time-span from 1970 to 2007. I attempted to incorporate as many countries as possible including both developing, developed and transition countries. Sample size fluctuates between the different specifications because of data availability. I estimate a pooled OLS model (1) using dummy variables for currency unions and trade agreements.

$$(FDI\ /\ GDP)_{it} = C + \beta_1 \mathrm{GDPGROWTH}_{it} + \beta_2\, \mathrm{RINTEREST}_{it} + \beta_3 \mathrm{INFLATION}_{it} + \beta_4 \mathrm{OPENNESS}_{it} + \beta_5 \mathrm{CURRENTACC}_{it} + \beta_6 \mathrm{RGDPWORK}_{it} + \beta_7 \mathrm{WTO}_{it} + \beta_8 \mathrm{EU}_{it} + \beta_9 \mathrm{CACM}_{it} + \beta_{10} \mathrm{CAN}_{it} + \beta_{11} \mathrm{CARICOM}_{it} + \beta_{12} \mathrm{EAC}_{it} + \beta_{13} \mathrm{EAEC}_{it} + \beta_{14} \mathrm{GCC}_{it} + \beta_{15} \mathrm{MERCOSUR}_{it} + \beta_{16} \mathrm{SACU}_{it} + \epsilon_{it}$$

Where the subscript i denote countries and t denotes time. The dependent variable $\mathrm{FDI/GDP}_{it}$ denotes FDI (inflows, outflows and net FDI) as a percentage of Gross Domestic Product (GDP) of a country i at time t. GDPGROWTH is annual percentage growth rate of GDP at market prices based on constant local currency. RINTEREST is the lending interest rate adjusted for inflation as measured by the GDP deflator. INFLATION is the inflation measured by the consumer price index. OPENNESS is the sum of exports and imports measured as a percentage of Gross Domestic Product. CURRENCTACC is the sum of net exports of goods, services, net income, and net current transfers as a percentage of GDP. RGDPWORK is the real GDP per worker (I$ per worker (in 2005 Constant Prices US$)). WTO, EU, CACM, CAN, CARICOM, EAC, EAEC, GCC, MERCOSUR and SACU are binary variables which take the value of 1 if a country i is a member of a given trade agreement at time t and zero otherwise.

To compute the effects of currency unions on foreign direct investment, pooled OLS regression is used.

$$(FDI\ /\ GDP)_{it} = \mathrm{C} + \beta_1 \mathrm{GDPGROWTH}_{it} + \beta_2\ \mathrm{INFLATION}_{it} + \beta_3 \mathrm{OPENNESS}_{it} + \beta_4 \mathrm{CURRENTACC}_{it} + \beta_5 \mathrm{RGDPWORK}_{it} + \beta_6 \mathrm{EUROZONE}_{it} + \beta_7 \mathrm{CEMAC}_{it} + \beta_8 \mathrm{WAEMU}_{it} + \beta_9 \mathrm{DOLLAR\_LTENDER}_{it} + \beta_{10} \mathrm{ECCA}_{it} + \epsilon_{it}$$

Where the subscript i denotes countries and t denotes time. The dependent variable $\mathrm{FDI/GDP}_{it}$ denotes FDI (inflows, outflows and net FDI) as a percentage of Gross Domestic Product (GDP) of a country i at time t. Same control variables are used in the second model except interest rate variable. EUROZONE, CEMAC, WAEMU, DOLLAR_LTENDER and ECCA are binary variables which take the value of 1 if a country i is a member of a given currency union.

The annual data for variables, net inflows of foreign direct investment as a percentage of GDP (inflows), net outflows of foreign direct investment as a percentage of GDP (outflows), GDP growth rate, inflation, openness and current account is collected from World Bank's World Development Indicators (WDI). The real GDP per worker variable data is sourced from Penn World Table 6.3. The data for the variables World Trade Organization (WTO), CACM, CAN, EAC, Caricom, EAEC, GCC, Mercosur

and SACU are collected from World Trade Organization. The data for currency unions is gathered from World Trade Organisation, Eastern Caribbean Central Bank, European Central Bank, Wei and Choi (2002), and the CIA World Factbook. Table 1 presents list of countries for the analysis of the effects of membership of currency unions and trade agreements on FDI. Table 2 shows the exact definitions of variables used in this study with data sources.

Table 1 Sample of countries for the analysis of the effects of trade agreements and currency unions on FDI

Afghanistan	Dominican	Lebanon	Serbia
Albania	Republic	Lesotho	Seychelles
Algeria	Ecuador	Liberia	Sierra Leone
Angola	Egypt	Libya	Singapore
Antigua and Barbuda	El Salvador	Lithuania	Slovak Republic
Argentina	Equatorial	Luxembourg	Slovenia
Armenia	Guinea	Macao, China	Solomon Islands
Aruba	Eritrea	Macedonia	Somalia
Australia	Estonia	Madagascar	South Africa
Austria	Ethiopia	Malawi	Spain
Azerbaijan	Fiji	Malaysia	Sri Lanka
Bahamas	Finland	Maldives	St. Kitts and
Bahrain	France	Mali	Nevis
Bangladesh	Gabon	Malta	St. Lucia
Barbados	Gambia	Mauritania	St. Vincent &
Belarus	Georgia	Mauritius	Grenadines
Belgium	Germany	Mexico	Sudan
Belize	Ghana	Moldova	Suriname
Benin	Greece	Mongolia	Swaziland
Bhutan	Grenada	Montenegro	Sweden
Bolivia	Guatemala	Morocco	Switzerland
Bosnia & Herzegovina	Guinea-Bissau	Mozambique	Syrian Arab
Botswana	Guinea	Namibia	Republic
Brazil	Guyana	Nepal	Sao Tome &
Brunei Darussalam	Haiti	Netherlands	Principe
Bulgaria	Honduras	Antilles	Tajikistan
Burkina Faso	Hong Kong	Netherlands	Tanzania
Burundi	China	New Zealand	Thailand
Cambodia	Hungary	Nicaragua	Togo
Cameroon	Iceland	Niger	Tonga
Canada	India	Nigeria	Trinidad and
Cape Verde	Indonesia	Norway	Tobago
Central African Republic	Iran	Oman	Tunisia
Chad	Ireland	Pakistan	Turkey
Chile	Israel	Panama	Turkmenistan
China	Italy	Papua New	Uganda
Colombia	Jamaica	Guinea	Ukraine
Comoros	Japan	Paraguay	United Kingdom
Congo Dem Rep	Jordon	Peru	United States
Congo Rep	Kazakhstan	Philippines	Uruguay
Costa Rica	Kenya	Poland	Uzbekistan
Cote d'Ivoire	Kiribati	Portugal	Vanuatu
Croatia	Korea Rep	Romania	Venezuela
Cyprus	Kuwait	Russia	Vietnam
Czech Republic	Kyrgyz Republic	Rwanda	Yemen Arab Rep
Denmark	Lao People's	Samoa	Zambia
Djibouti	Dem. Rep	Saudi Arabia	Zimbabwe
Dominica	Latvia	Senegal	

Table 2 Variables with definitions and sources

Variable	Definition	Sources
INFLOW	Net inflows of foreign direct Investment as a percentage of GDP	World Bank's World Development Indicators, The World Bank
OUTFLOW	Net outflows of foreign direct investment as a percentage of GDP	World Bank's World Development Indicators, The World Bank
WTO	WTO membership (153 members on 23 July 2008 (with dates of membership)	World Trade Organization
ECCA	East Caribbean Currency Area	Eastern Caribbean Central Bank
CEMAC	Economic and Monetary Community of Central Africa	International relations and cooperation Website, World Trade Organization
WAEMU	The West African Economic and Monetary Union	World Trade Organization and individual RTAs
EU	European union membership	Europa
GDPGROWTH	Annual percentage growth rate of GDP at market prices based on constant local currency	World Bank World Development Indicators, The World Bank
RINTEREST	Real interest rate	World Bank World Development Indicators, The World Bank
EURO	Member Countries of EMU	European Central Bank
OPENNESS	Sum of exports and imports of goods and services measured as a share of gross domestic product.	World Bank World Development Indicators, The World Bank
CURRENTACC	The sum of net exports of goods, services, net income, and net current transfers as a percentage of GDP	World Bank World Development Indicators, The World Bank
RGDPWORK	The real GDP per worker (in thousands of dollars per worker (in 2005 Constant Prices US$)	Penn World Tables PWT 6.3
DOLLAR	Countries using dollars as legal tender	Wei and Choi (2002), CIA the World Fact Book
CACM	Central American Common Market	World Trade Organization and individual RTAs
CAN	Andean Community	World Trade Organization and individual RTAs
CARICOM	Caribbean Community and Common Market	World Trade Organization and individual RTAs
EAC	East African Community	World Trade Organization and individual RTAs
EAEC	Eurasian Economic Community	World Trade Organization and individual RTAs
GCC	Gulf Cooperation Council	World Trade Organization and individual RTAs ,
MERCOSUR	Southern Common Market	World Trade Organization and individual RTAs
SACU	Southern African Customs Union	World Trade Organization and individual RTAs

The data for dummy variables of trade agreements is based on the year of entry into force. The data for currency unions is selected on the basis of the year of entry into the currency unions. The main economic variables have been selected on theoretical grounds.

4.6 Results

Descriptive statistics for the selected variables of currency unions and regional trade agreements are given in Table 3. The results for trade agreements are presented in Table 6, 7 and 8. The estimation method used is pooled OLS and expected signs for each variable are reported. The results for currency unions are presented in Table 9, 10 and 11.

Table 3 Descriptive statistics for the effects of Regional Trade Agreements and Currency Unions

Variables	Mean	Median	Std. Dev.
INFLOW	3.3042	1.2000	14.3548
OUTFLOW	1.6476	0.0900	17.3884
INFLOW-OUTFLOW	1.9147	0.8700	5.9656
GDP_GROWTH	3.9492	4.0800	6.3040
RINTEREST	5.9172	5.7800	19.2214
INFLATION	36.7872	6.3500	507.7638
OPENNESS	75.1272	64.7750	46.1430
CURRENTACC	-3.4922	-2.9600	10.5470
RGDPWORK	20.4552	12.6891	24.4904
WTO	0.2177	0.0000	0.4127
EU	0.0649	0.0000	0.2463
CACM	0.0271	0.0000	0.1624
CAN	0.0117	0.0000	0.1075
CARICOM	0.0502	0.0000	0.2184
EAC	0.0035	0.0000	0.0592

EAEC	0.0068	0.0000	0.0822
GCC	0.0027	0.0000	0.0521
MERCOSUR	0.0082	0.0000	0.0900
SACU	0.0019	0.0000	0.0439
EUROZONE	0.0138	0.0000	0.1168
CEMAC	0.0068	0.0000	0.0822
WAEMU	0.0071	0.0000	0.0842
DOLLARS_LEGALTENDER	0.0075	0.0000	0.0862
ECCA	0.0307	0.0000	0.1726

Table 3 shows the descriptive statistics for the effects of RTAs and CUs on FDI over the period of 1970-2007. Table 3 reports that the average rate of economic growth is 3.95% per annum for the entire sample. On average, the real interest rate is 5.9 percent. The Inflation rate of 36% seems high and it is mainly due to developing countries. Openness is 75%, which shows that most of the countries have trade encouraging policies. One of the reasons may be that a large number of countries are members of different regional trade agreements, especially *WTO* which promotes trade liberalization. Since productive workforce encourages FDI, I also examine the real GDP per worker, which averages 20.4552 thousands of international dollars. Table 3 shows that out of 180 countries around 22% countries belong to WTO. EU members account for 6% of the entire sample. The membership of *Caricom, CACM, CAN, Mercosur, EAC, EAEC* and *GCC* have about 5%, 2%, 1%, 0.82%, 0.35%, 0.68% and 0.27% respectively in the sample used in the study of RTAs.

Among the CUs, around 3% of countries are members in ECCA. Eurozone members comprise of about 1.4% of the data sample. African currency unions (CEMAC and WAEMU) have approximately 0.68% and 0.71% members in the sample. Officially dollarized countries are about 0.75% of the entire sample.

Table 4 Correlation matrix for trade agreements

	INFLOW	OUTFLOW	INFLOW-OUTFLOW	GDP_GROWTH	RINTEREST	INFLATION	OPENNESS	CURRENTACC	RGDPWORK	WTO	EU	CACM	CAN	CARICOM	EAC	EAEC	GCC	MERCOSUR	SACU
INFLOW	1.0000																		
OUTFLOW	0.4578	1.0000																	
INFLOW-OUTFLOW	0.7721	-0.2115	1.0000																
GDP_GROWTH	0.1796	0.0133	0.1879	1.0000															
RINTEREST	0.0208	-0.0304	0.0446	0.0030	1.0000														
INFLATION	-0.0442	-0.0509	-0.0122	-0.1656	-0.2391	1.0000													
OPENNESS	0.4011	0.2418	0.2681	0.1456	-0.0151	-0.0174	1.0000												
CURRENTACC	-0.3424	0.1075	-0.4532	-0.0443	-0.1191	0.0159	0.0270	1.0000											
RGDPWORK	0.0503	0.3508	-0.1954	-0.0736	-0.0975	-0.0876	0.1262	0.3765	1.0000										
WTO	0.1876	0.1734	0.0823	0.0878	0.1138	-0.0908	0.1747	0.1048	0.1711	1.0000									
EU	0.0695	0.2648	-0.1128	-0.0586	-0.0639	-0.0654	0.0237	0.0645	0.4094	0.0718	1.0000								
CACM	0.0101	-0.0418	0.0410	0.0163	0.0184	0.0010	0.0105	-0.0784	-0.0833	0.0848	-0.0623	1.0000							

CAN	-0.0054	-0.0418	0.0239	-0.0165	0.1029	0.0353	-0.1413	0.0384	-0.1050	0.0803	-0.0789	-0.0303	1.0000					
CARICOM	0.0793	-0.0704	0.1375	-0.0152	0.0100	-0.0306	0.1850	-0.1913	-0.0280	-0.0487	-0.1062	-0.0408	-0.0516	1.0000				
EAC	-0.0069	-0.0299	0.0137	0.0542	0.0312	-0.0125	-0.0765	-0.0162	-0.1132	0.1090	-0.0411	-0.0158	-0.0200	-0.0269	1.0000			
EAEC	-0.0011	-0.0173	0.0112	0.0814	-0.0907	0.0549	0.0410	0.0245	-0.0793	-0.0738	-0.0512	-0.0197	-0.0249	-0.0335	-0.0130	1.0000		
GCC	-0.0030	0.0384	-0.0308	0.0531	-0.0586	-0.0151	0.0465	0.1677	0.0678	0.0769	-0.0290	-0.0111	-0.0141	-0.0189	-0.0073	-0.0091	1.0000	
MERCOSUR	-0.0166	-0.0322	0.0047	-0.0385	0.2494	-0.0145	-0.0973	0.0216	-0.0420	0.1557	-0.0610	-0.0234	-0.0297	-0.0399	-0.0154	-0.0192	-0.0109	1.0000
SACU	-0.0097	-0.0184	0.0025	0.0139	-0.0141	-0.0114	0.0433	0.0358	-0.0188	0.0868	-0.0327	-0.0126	-0.0159	-0.0214	-0.0083	-0.0103	-0.0058	-0.0123	1.0000

Table 5 Correlation matrix for Currency Unions

	INFLOW	OUTFLOW	INFLOW-OUTFLOW	GDP_ GROWTH	INFLATION	OPENNESS	CURRENTACC	RGDPWORK	EUROZONE	CEMAC	WAEMU	DOLLARS_ LEGALTENDER	ECCA
INFLOW	1.0000												
OUTFLOW	0.9498	1.0000											
INFLOW-OUTFLOW	-0.0792	-0.3871	1.0000										
GDP_GROWTH	0.0560	0.0076	0.1406	1.0000									
INFLATION	-0.0210	-0.0143	-0.0165	-0.1022	1.0000								
OPENNESS	0.3154	0.2387	0.1690	0.1327	-0.0812	1.0000							
CURRENTACC	-0.0497	0.0815	-0.4062	-0.0140	0.0149	0.0446	1.0000						
RGDPWORK	0.1465	0.1994	-0.2036	-0.0264	-0.0566	0.1802	0.4248	1.0000					
EUROZONE	0.2537	0.2804	-0.1456	-0.0363	-0.0310	0.0971	0.0557	0.2833	1.0000				
CEMAC	-0.0021	-0.0083	0.0202	-0.0312	-0.0149	0.0082	0.0689	-0.0587	-0.0177	1.0000			
WAEMU	-0.0096	-0.0111	0.0074	0.0019	-0.0179	-0.0441	-0.0792	-0.1099	-0.0224	-0.0102	1.0000		
DOLLARS_LEGALTENDER	0.0001	-0.0122	0.0392	0.0007	-0.0155	0.1236	-0.0005	-0.1008	-0.0248	-0.0113	-0.0143	1.0000	
ECCA	0.0370	-0.0169	0.1630	0.0335	-0.0229	0.1866	-0.2178	-0.0675	-0.0343	-0.0156	-0.0198	-0.0219	1.0000

Table 4 and 5 provides the correlation coefficients matrices for RTAs and CUs. Table 4 shows that FDI inflows as a percentage of GDP are positively correlated to GDP growth, real interest rate, trade openness, real GDP per worker, WTO, EU, CACM, and CARICOM. The correlation coefficient between the GDP growth rate and FDI outflow is 1% and around 18% for FDI inflows and net FDI, which suggests that investors also consider other economic factors when deciding to invest abroad. Real interest rate seems to have very low correlation with inflow, outflow and net FDI; 2%, -3% and 4% respectively. Inflation has also relatively low and negative correlation with all three dependent variables. Among all control variables, openness is highly correlated with FDI inflows, which corroborates theoretical predictions that more open economies are able to attract more FDI. On the other hand, the correlation of openness with FDI outflow and net FDI is somewhat lower. There is a robust inverse relationship between the current account and both FDI inflows and net FDI. The reason for this relationship can be found in the Balance of Payment (BoP) accounting. Under floating exchange rate regimes, the flows of goods and investments have to offset each other in order for the economy to remain in equilibrium.

Similarly, FDI flows are negatively correlated with inflation, current account, CAN, EAC, EAEC, GCC, Mercosur and SACU. There is about 0.38 correlation between real GDP per worker and current account, as more productive nations export more goods. The correlation matrix shows about 0.41 correlation between EU and real GDP per worker, which may indicate

that output per worker is affected by the membership to EU. This result may point to the free movement of labor between member countries. The correlation among the explanatory variables is not high, which indicates small likelihood of multicollinearity problem.

Table 5 reports the correlation coefficient matrix of currency unions. The correlation between economic variables and FDI flows in Table 5 differs insignificantly to the estimates provided in Table 4 due to different number of observations. GDP growth has negative correlation with Eurozone and CEMAC and positive correlation with WEAMU, dollar and ECCA. Inflation has negative correlation with all currency unions which indicate the decrease in inflation rate in economies joining CUs. Openness has negative correlation with WAEMU and positive with other unions. This may point to the liberalization policies of the unions. Current account is negative with WAEMU, dollar and ECCA and positive with the remaining.

Table 6 OLS Regression showing the impact of Regional Trade Agreements on Foreign Direct Investment Inflows

Variables	Coefficient	Expected signs
Intercept	-3.4592*** (0.2357)	
GDP_GROWTH	0.1366*** (0.0197)	+
RINTEREST	-0.0123* (0.0076)	–
INFLATION	-0.0001 (0.0003)	–
OPENNESS	0.0479*** (0.0021)	+
CURRENTACC	-0.2530*** (0.0109)	–
RGDPWORK	0.0306*** (0.0053)	+
WTO	1.7368*** (0.1901)	+
EU	0.3967 (0.3099)	+
CACM	-0.5933 (0.4728)	+
CAN	2.0940*** (0.5075)	+
CARICOM	-0.8854** (0.3436)	+
EAC	0.3786 (0.9933)	+
EAEC	-0.0079 (0.7735)	+
GCC	1.4760 (1.4585)	+
MERCOSUR	0.7790 (0.6562)	+
SACU	-1.7653 (1.2816)	+
Number of Countries	180	
Observations	2944	
R2	0.3230	
F-statistic	13.22351*** (10, 2927)	
Chi-square	132.2351*** (10)	

This table presents results of OLS regression relating Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) to regional trade agreements. The dependent variable is the FDI net inflows as a percentage of Gross Domestic Product (GDP), defined as net inflows (investment inflows minus disinvestment) in the countries from foreign investors, divided by country

GDP. The data set consists of Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) of 180 countries from 1970-2007 for customs unions. GDPGROWTH is annual percentage growth rate of GDP at market prices based on constant local currency. RINTEREST is the lending interest rate adjusted for inflation as measured by the GDP deflator. INFLATION is the inflation measured by the consumer price index. OPENNESS is the sum of exports and imports of goods and services measured as a share of gross domestic product. CURRENTACC Current account balance is the sum of net exports of goods, services, net income, and net current transfers as a percentage of GDP. RGDPWORK is the real GDP per worker (I$ 1000 per worker (in 2005 Constant Prices US$). WTO is a binary variable which is unity if i country is member to WTO in time t. EU is a binary variable which is 1 if country i is member to European union in time t. CACM is a binary variable which is 1 if country i is member to Central American Common Market in time t. CAN is a binary variable which is 1 if country i is member to Andean Community in time t and zero otherwise. CARICOM is a binary variable which is 1 if country i is member to Caribbean Community and Common Market in time t. EAC is a binary variable which is 1 if country i is member to East African Community in time t. EAEC is a binary variable which is 1 if country i is member to Eurasian Economic Community in time t. GCC is a binary variable which is 1 if country i is member to Gulf Cooperation Council in time t. MERCOSUR is a binary variable which is 1 if country i is member to MERCOSUR in time t. SACU is a binary variable which is 1 if country i is member to Southern African Customs Union in time t. *, **, and *** represents statistical significance of 10 percent, 5 percent, and 1 percent, respectively. Standard error is given in parentheses. Degrees of freedom are included in parentheses for F-stat and Chi-square.

The results in Table 6 showing the impact of Regional Trade Agreements on FDI inflows reveal that GDPGROWTH is statistically significant with expected positive sign, which shows that FDI inflows increases with the rise in economic growth. Inflation is observed to be statistically insignificant in the both regressions focusing on trade agreements and currency unions. Notably, the inflation coefficient for trade agreements has the expected sign and positive for currency unions. The regression results show that openness variable is positive and statistically significant at the 1 percent level for all of the models considered, suggesting the increase of vertical, export-oriented and other FDI inflows as a result of enlarged market size and improved economic environment in the member countries.

WTO membership has a highly significant and positive impact on FDI inflows. WTO is well known for its pivotal role in promoting trade among countries. WTO promotes trade liberalization and friendly business environment which also encourages the foreign investments in the member countries. CAN is highly significant and positive with a coefficient of 2.09. CAN is able to achieve its integration objectives because of the condition that member countries cannot join other RTAs. As spaghetti bowl effect (joining more than one RTAs) affects the attainment of diverse and sometimes conflicting goals and objectives of these RTAs (Daniels et al 2009). Further, the radical increase in FDI inflows to the members is associated due to the implementation of Commission Decision 220 by CAN which relaxed the FDI

regulations such as liberation of repatriation of earnings and liberty to invest in different sectors (Bonnett 2004).

EU membership has positive, but insignificant effect on FDI inflows on the member states, showing that EU membership does not make a radical difference to the FDI inflows of its member. This is quite consistent with the inflows into EU dropping from 38.65 in 1970 to 32.29 in 2009 as a percentage of total world inflow (UNCTAD STAT 2010a).

CACM, EAEC and SACU have negative and insignificant effect contrary to expectations, showing that inflows might slightly decrease to countries, if they become members. This may be because of the unstable political conditions, costly labor, higher transportation costs, lack of policy credibility, poor quality of labor, and lack of powerful and established institutional systems for property rights (Woodward and Rolfe 1993; Elbadawi and Mwega 1998).

The coefficient of GCC has positive but insignificant effect on FDI. This indicates that membership to GCC turned out to be of no major consequence to FDI. This also supports the analysis of Mina (2007), who conducted a panel data study on the effects of location determinants of FDI among GCC nations over the period 1980 to 2002 and found that GCC countries were not receiving FDI inflows up to their full potential. According to UNCTAD Matrix of inward FDI performance and potential 2006 (UNCTAD 2011a), 4 out of 6 GCC countries; Bahrain, Oman, Saudi Arabia and United Arab Emirates are considered the high FDI Potential and high

Performance countries. The remaining two Kuwait and Qatar are considered high FDI potential but low FDI performance countries (their performance is considered below potential). Despite low ability to attract FDI, GCC countries are "very open economies" when compared to other oil producing countries and they are relatively highly globalized (Peeters 2010:3). Another reason for FDI inflows and outflows may be that all GCC countries are oil exporters. Therefore, the membership in GCC may not necessarily lead to additional FDIs in the extraction of mineral resources, which would take place regardless of the trade agreements.

The slope of CARICOM is negative and significant at 5%, meaning that the membership to CARICOM decreases the inflows into member countries. This is linked to the fact that the FDI of CARICOM is 0.37 percent of total world FDI inflows (UNCTAD STAT 2010b). There is less FDI inflows in CARICOM region, presumably because of the inadequacy of the domestic firms for mergers and acquisitions (not ready and unsuitable). That is why foreign firms make mostly greenfield investments in the region. Further, Trinidad and Tobago, Bahamas and Jamaica receive a large share of CARICOM FDI inflows with remaining members being the followers in line (Mohan and Watson 2010).

The coefficient on EAC and MERCOSUR are positive and insignificant. The reason for the insignificant relationship between FDI and MERCOSUR is the economic and political instability in the Latin American region and "poor economic relation" between member countries (Daniels et

al. 2009:158). The rationale for the inconsequential association between EAC and FDI inflows could be related to the implementation of strict FDI and commercial laws. EAC member country governments have imposed different limitations on foreign investments such as export quotas, employment of locals, capital requirements, etc. (Daniel 2010).

Table 7 OLS Regression showing the impact of Regional Trade Agreements on Foreign Direct Investment Outflows

Variables	Coefficient	Expected signs
Intercept	-2.0063*** (0.2107)	
GDP_GROWTH	-0.0033 (0.0179)	–
RINTEREST	-0.0034 (0.0070)	–
INFLATION	-0.0010 (0.0016)	+
OPENNESS	0.0177*** (0.0017)	+
CURRENTACC	-0.0166* (0.0098)	–
RGDPWORK	0.0496*** (0.0045)	+
WTO	0.6556*** (0.1669)	+
EU	1.5600*** (0.2457)	+
CACM	-0.7014 (0.5129)	+
CAN	0.3494 (0.4207)	+
CARICOM	-1.4654*** (0.3206)	+
EAC	0.3665 (0.7748)	+
EAEC	0.1704 (0.6201)	+
GCC	0.6686 (1.0882)	+
MERCOSUR	-0.1608 (0.5474)	+
SACU	-1.2817 (0.9532)	+
Number of Countries	180	
Observations	2160	
R2	0.1985	
F-statistic	9.5007*** (10, 2143)	
Chi-square	95.0067*** (10)	

This table presents results of OLS regression relating Foreign Direct Investment (FDI) net outflows as a percentage of Gross Domestic Product (GDP) to regional trade agreements. The dependent variable is FDI net inflows as a percentage of Gross Domestic Product (GDP), defined as net inflows (investment inflows minus disinvestment) in the countries from foreign investors, divided by country GDP.

The data set consists of Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) of 180 countries from 1970-2007 for customs unions. GDPGROWTH is annual percentage growth rate of GDP at market prices based on constant local currency. RINTEREST is the lending interest rate adjusted for inflation as measured by the GDP deflator. INFLATION is the inflation measured by the consumer price index. OPENNESS is the sum of exports and imports of goods and services measured as a share of gross domestic product. CURRENTACC Current account balance is the sum of net exports of goods, services, net income, and net current transfers. RGDPWORK is the real GDP per worker (I$ 1000 per worker (in 2005 Constant Prices US$). WTO is a binary variable which is unity if i country is member to WTO in time t. EU is a binary variable which is 1 if country i is member to European union in time t. CACM is a binary variable which is 1 if country i is member to Central American Common Market in time t. CAN is a binary variable which is 1 if country i is member to Andean Community in time t and zero otherwise. CARICOM is a binary variable which is 1 if country i is member to Caribbean Community and Common Market in time t. EAC is a binary variable which is 1 if country i is member to East African Community in time t. EAEC is a binary variable which is 1 if country i is member to Eurasian Economic Community in time t. GCC is a binary variable which is 1 if country i is member to Gulf Cooperation Council in time t. MERCOSUR is a binary variable which is 1 if country i is member to MERCOSUR in time t. SACU is a binary variable which is 1 if country i is member to Southern African Customs Union in time t. *, **, and *** represents statistical significance of 10 percent, 5 percent, and 1 percent, respectively. Standard error is given in parentheses. Degrees of freedom are included in parentheses for F-stat and Chi-square.

In Table 7, I present the regression results on the effects of RTAs on FDI outflows for 180 countries for the period of 1970-2007. The variable WTO membership has a positive and highly significant effect on FDI outflows of RTA members. When joining WTO, the FDIs tend to increase by around 0.66% of GDP, everything else kept constant. This may be due to the fact that WTO induces its members to make their economic environment conducive to investment, which in turn increases competition in the local market and leads to outward FDI in the rival firms' countries. As markets become more open and countries saturated as a result of WTO membership, competent businesses are forced to find other markets.

EU is positive and highly significant implying increase in investments from EU countries. The share of FDI outflows from EU was recorded above 50 percent of total FDI outflows from developed countries (UNCTAD 2007). The biggest beneficiaries of FDI outflows from EU are USA, Canada and Central America. The impact of CARICOM is significant at 1% with the coefficient of -1.47.

Coefficients on CACM, Mercosur and SACU are negative and insignificant. This indicates that the outward FDI might decrease with the membership and turn into intra-regional trade among member countries. The reason of negative relationship of SACU membership with FDI outflow may be that South African countries are primarily agricultural, less developed countries. These economies are mostly reliant on exports and FDI inflows. These South African countries share the same economic problems (Krapohl

and Muntschick 2008). Therefore, if any country from the South African region joins SACU, it is very unlikely that membership would increase their FDI outflows.

CAN, EAC, EAEC and GCC have a positive, but insignificant impact on FDI outflows. According to UNCTAD Outward FDI performance index 2005-2007 (UNCTAD 2011b), GCC countries are considered to be within the high potential and high performance category. The study finds GCC membership with the correct but insignificant sign.

As expected, GDP growth has negative effect on FDI outflows in the trade agreements regressions, because in presence of GDP growth in a country, businesses and investors have lower incentives to invest abroad. Increase in real interest has inverse, but insignificant effects on outflows which may suggest that businesses take loans from home country to finance the FDI. Inflation in the home country reduces FDI outflow. The purchasing power of liquid assets held by the companies is eroded, which reduces the capacity of a business to invest abroad. Openness is assumed to increase OFDI, as the internal competition increases with market saturation, which compels the outward investors to enter in the competitors markets. Current account is reported with the expected sign and is only marginally significant at the 10%. Real GDP per worker is highly significant for FDI outflows indicating the importance of productive workers in the establishment of multinational enterprises.

Table 8 OLS Regression showing the impact of Regional Trade Agreements on net Foreign Direct Investment (inflows-outflows)

Variables	Coefficient	Expected signs
Intercept	-1.8207*** (0.2743)	
GDP_GROWTH	0.1482*** (0.0233)	+
RINTEREST	-0.0169* (0.0092)	-
INFLATION	0.0010 (0.0021)	-
OPENNESS	0.0313*** (0.0023)	+
CURRENTACC	-0.2879*** (0.0127)	-
RGDPWORK	-0.0068 (0.0059)	+
WTO	0.8167*** (0.2162)	+
EU	-1.1136*** (0.3181)	+
CACM	-0.3044 (0.6630)	+
CAN	2.1124*** (0.5439)	+
CARICOM	0.0756 (0.4216)	+
EAC	0.5448 (1.0017)	+
EAEC	0.0288 (0.8019)	+
GCC	1.6295 (1.4069)	+
MERCOSUR	1.4893** (0.7080)	+
SACU	-0.1378 (1.2322)	+
Number of Countries	180	
Observations	2140	
R2	0.3216	
F-statistic	5.6798*** (10, 2123)	
Chi-square	56.7979*** (10)	

This table presents results of OLS regression relating Foreign Direct Investment (FDI) net flows (Inflows-Outflows) as a percentage of Gross Domestic Product (GDP) to regional trade agreements. The dependent variable is FDI net inflows as a percentage of Gross Domestic Product (GDP), defined as net inflows (investment inflows minus disinvestment) in the countries from foreign investors,

divided by country GDP. The data set consists of Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) of 180 countries from 1970-2007 for customs unions. GDPGROWTH is annual percentage growth rate of GDP at market prices based on constant local currency. RINTEREST is the lending interest rate adjusted for inflation as measured by the GDP deflator. INFLATION is the inflation measured by the consumer price index. OPENNESS is the sum of exports and imports of goods and services measured as a share of gross domestic product. CURRENTACC Current account balance is the sum of net exports of goods, services, net income, and net current transfers. RGDPWORK is the real GDP per worker (I$ 1000 per worker (in 2005 Constant Prices US$). WTO is a binary variable which is unity if i country is member to WTO in time t. EU is a binary variable which is 1 if country i is member to European union in time t. CACM is a binary variable which is 1 if country i is member to Central American Common Market in time t. CAN is a binary variable which is 1 if country i is member to Andean Community in time t and zero otherwise. CARICOM is a binary variable which is 1 if country i is member to Caribbean Community and Common Market in time t. EAC is a binary variable which is 1 if country i is member to East African Community in time t. EAEC is a binary variable which is 1 if country i is member to Eurasian Economic Community in time t. GCC is a binary variable which is 1 if country i is member to Gulf Cooperation Council in time t. MERCOSUR is a binary variable which is 1 if country i is member to MERCOSUR in time t. SACU is a binary variable which is 1 if country i is member to Southern African Customs Union in time t. *, **, and *** represents statistical significance of 10 percent, 5 percent, and 1 percent, respectively. Standard error is given in parentheses. Degrees of freedom are included in parentheses for F-stat and Chi-square.

The results for the relationship between Net FDI (inflows-outflows) and RTAs are presented in Table 8. The table reports that WTO and CAN have robust and highly significant effect, suggesting that the membership to WTO and CAN increases the net FDI flows (inflows-outflows) to the member countries. As WTO membership provide the benefit of increased investments and reduced restrictions among the member countries. Membership in CAN increases net FDI flows in the member countries through the formation and successful implementation of investment liberalization policies and investment provisions. The coefficient on EU is negative and highly significant, which is quite an important result showing the membership, on the whole, reduces the net FDI to the members. This result is coherent with the European Union foreign direct investment yearbook 2008 (Eurostat 2008), which shows substantial FDI outflows from EU in the year 2005 in the sectors of financial intermediation, petroleum, chemical, rubber and food production.

The coefficient on CACM and SACU are negative, but insignificant. The membership in SACU does not bring promising increases in FDI, due to its production in agricultural goods and dependence on exports. Further, South African countries invest in other regions and their FDI inflows mainly come from Northern countries. Slopes on Caricom, EAC, EAEC, and GCC are positive but insignificant. Although, Caricom is observed as a net capital importer with a substantial increase in its FDI inflows when compared to its outflows and it offers the free movement of capital within the members

(UNCTAD 2008), the membership might have insignificant effect due to small size of its economies and tax competition among its members. The coefficient on Mercosur shows significant impact on net FDI at 5%, which indicates that membership to Mercosur, on the whole, increases FDI flows due to privatization of public sector and improved economic environment of members.

Table 9 OLS Regression showing the impact of Currency Unions on Foreign Direct Investment inflows

Variable	Coefficient	Expected signs
Intercept	-6.7169*** (0.5425)	
GDP_GROWTH	0.0996** (0.0475)	+
INFLATION	0.0005 (0.0008)	–
OPENNESS	0.0923*** (0.0053)	+
CURRENTACC	-0.2043*** (0.0284)	–
RGDPWORK	0.0535*** (0.0118)	+
EUROZONE	19.7576*** (1.4345)	+
CEMAC	6.1140** (2.7741)	+
WAEMU	0.8445 (2.0731)	+
DOLLARS_LEGALTENDER	-2.4325 (2.1362)	+
ECCA	-0.8391 (1.4822)	+
Number of Countries	180	
Observations	3804	
R2	0.1574	
F-statistic	39.4786*** (5, 3793)	
Chi-square	197.3932*** (5)	

This table presents results of OLS regression relating Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) to regional trade agreements. The dependent variable is FDI net inflows as a percentage of Gross Domestic Product (GDP), defined as net inflows (investment inflows minus disinvestment) in the countries from foreign investors, divided by country GDP. The data set consists of Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) of 180 countries from 1970-2007 for customs unions. GDPGROWTH is annual percentage growth rate of GDP at market prices based on constant local currency. RINTEREST is the lending interest rate adjusted for inflation as measured by the GDP deflator. INFLATION is the inflation measured by the consumer price index. OPENNESS is the sum of

exports and imports of goods and services measured as a share of gross domestic product. CURRENTACC Current account balance is the sum of net exports of goods, services, net income, and net current transfers. RGDPWORK is the real GDP per worker (I$ 1000 per worker (in 2005 Constant Prices US$). EUROZONE is a binary variable which is 1 if country i is member to Economic and Monetary Union (EMU) of European Union in time t. CEMAC is a binary variable which is 1 if country i is member to Economic and Monetary Community of Central Africa in time t. WAEMU is a binary variable which is 1 if country i is member to West African Economic and Monetary Union (WAEMU) in time t. DOLLAR_LTENDER is a binary variable which is 1 if country i is using dollar as legal tender. *, **, and *** represents statistical significance of 10 percent, 5 percent, and 1 percent, respectively. Degrees of freedom are included in parentheses for F-stat and Chi-square.

Table 9 reports the pooled OLS regression results on the impact of the CU membership on FDI inflows for 180 countries over the period of 1970-2007. Eurozone is positive and highly significant showing FDI inflows will increase by around 20% of GDP for new members of EMU. This may be due to the fixed value of the currency relative to other members. Additionally, controlled monetary policy, established political and economic conditions may promote further stability. Foreign investors are attracted towards the countries with stable exchange rates to avoid the higher costs of doing business (Mohan and Watson 2010).

CEMAC exerts a strong and positive influence on the inward FDI. The relationship between CEMAC and WAEMU is a curious one. The two currency unions are prominent groups of Africa. Even though, the members of both currency unions rank low in terms of human development, infrastructure and ease of doing business index, the substantial impact of the membership of CEMAC shows its advantageous position in comparison to WAEMU. CEMAC has the natural advantage in terms of FDI inflows, due to the existence of oil resources, which is also the reason for increased its exports[4]. This suggests that CEMAC attracts more export-oriented FDI. Further, economic growth was stable in CEMAC due to oil production. On the other hand, WAEMU had a relatively unsteady growth rate. WAEMU consist of agricultural countries with commodity exports and increased population growth rate (Ramirez and Tsangarides 2007; Alby 2007). The

[4] All the countries of CEMAC are oil producing countries except Central African Republic.

performance of CEMAC countries, as measured by the human development index and in terms of productivity, is much better than WAEMU members (Ramirez and Tsangarides 2007). However, they both have strict investment policies in terms of labor regulations, start-up capital requirements, and costly property registration processes, when compared to Sub-Saharan Africa.

Dollar and ECCA appear both negative and insignificant in the regressions. Joining ECCA may decrease the FDI inflows by 0.83% of GDP. Although, ECCA members grant a large number of tax concessions to foreign investors for instance tax holidays, these tax incentives have moderate effects on FDI to the members and even lower their revenues (Chai and Goyal 2008). Further, more than half of FDI inflows in ECCA are in tourism industry (Cubeddu et al. 2008), in which these countries have a comparative advantage.

The coefficient on dollarization is inversely related to the inflows of FDIs. This suggests that dollarization of countries may not prove beneficial to the dollarized countries, which may be due to inability of dollarized countries to handle the external shocks resulting in reduced investments.

Table 10 OLS Regression showing the impact of Currency Unions on Foreign Direct Investment outflows

Variable	Coefficient	Expected signs
Intercept	-7.2852*** (0.8088)	
GDP_GROWTH	-0.0265 (0.0731)	-
INFLATION	0.0025 (0.0034)	+
OPENNESS	0.0860*** (0.0076)	+
CURRENTACC	0.0314 (0.0427)	
RGDPWORK	0.0682*** (0.0168)	+
EUROZONE	23.0326*** (1.8245)	+
CEMAC	-0.5987 (3.7431)	+
WAEMU	2.1403 (2.9727)	+
DOLLARS_LEGALTENDER	-3.7267 (2.7162)	+
ECCA	-4.3532** (2.0034)	+
Number of Countries	180	
Observations	2799	
R2	0.1348	
F-statistic	33.81653*** (5, 2788)	
Chi-square	169.0827*** (5)	

This table presents results of OLS regression relating Foreign Direct Investment (FDI) net outflows as a percentage of Gross Domestic Product (GDP) to regional trade agreements. The dependent variable is FDI net inflows as a percentage of Gross Domestic Product (GDP), defined as net inflows (investment inflows minus disinvestment) in the countries from foreign investors, divided by country GDP. The data set consists of Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) of 180 countries from 1970-2007 for customs unions. GDPGROWTH is annual percentage growth rate of GDP at market prices based on constant local currency. RINTEREST is the lending interest rate adjusted for inflation as measured by the GDP deflator. INFLATION is the inflation measured by the consumer price index. OPENNESS is the sum of

exports and imports of goods and services measured as a share of gross domestic product. CURRENTACC Current account balance is the sum of net exports of goods, services, net income, and net current transfers. RGDPWORK is the real GDP per worker (I$ 1000 per worker (in 2005 Constant Prices US$). EUROZONE is a binary variable which is 1 if country i is member to Economic and Monetary Union (EMU) of European Union in time t. CEMAC is a binary variable which is 1 if country i is member to Economic and Monetary Community of Central Africa in time t. WAEMU is a binary variable which is 1 if country i is member to West African Economic and Monetary Union (WAEMU) in time t. DOLLAR_LTENDER is a binary variable which is 1 if country i is using dollar as legal tender. *, **, and *** represents statistical significance of 10 percent, 5 percent, and 1 percent, respectively. Standard error is given in parentheses. Degrees of freedom are included in parentheses for F-stat and Chi-square.

In table 10, I analyse the relationship between CUs and FDI outflow for the period of 1970-2007. The membership to EUROZONE is expected to bring 23% increase in FDI outflows. The result complements the increase in recent FDI outflows from euro countries. The membership of euro may affect the diversification opportunities for home businesses resulting in an increase in outflows in non-member countries (Haselmann and Herwartz 2010; Eurostat 2008).

The regression results show that joining ECCA will decrease 4.35% of the FDI outflows of member states. This might be due to capital controls, political and economic conditions in ECCA members.

The membership of CEMAC have a negative and insignificant impact on members, indicating lower domestic investments presumably due to "macroeconomic and institutional environment" for businesses in the region (Ndiaye 2010:19). Dollarization may not positively affect the FDI outflows of countries. The reason for negative and insignificant impact of dollarization might be due to small economies. The coefficient on WAEMU for FDI outflows appears insignificant with the expected sign. The result indicates the need of economic freedom in the region in the areas of trade and direct investments (Vamvakidis 1998).

Table 11 OLS Regression showing the impact of Currency Unions on net Foreign Direct Investment

Variable	Coefficient	Expected signs
Intercept	-0.9736*** (0.2422)	
GDP_GROWTH	0.1381*** (0.0219)	+
INFLATION	0.0007 (0.0010)	–
OPENNESS	0.0231*** (0.0023)	+
CURRENTACC	-0.2626*** (0.0128)	–
RGDPWORK	-0.0065 (0.0050)	+
EUROZONE	-3.9648*** (0.5427)	+
CEMAC	3.0377*** (1.1130)	+
WAEMU	-1.0541 (0.8840)	+
DOLLARS_LEGALTENDER	0.5659 (0.8077)	+
ECCA	1.2190** (0.6097)	+
Number of Countries	180	
Observations	2754	
R2	0.2356	
F-statistic	13.61564*** (5, 2743)	
Chi-square	68.07822*** (5)	

This table presents results of OLS regression relating Foreign Direct Investment (FDI) net flows (Inflows-Outflows) as a percentage of Gross Domestic Product (GDP) to regional trade agreements. The dependent variable is FDI net inflows as a percentage of Gross Domestic Product (GDP), defined as net inflows (investment inflows minus disinvestment) in the countries from foreign investors, divided by country GDP. The data set consists of Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) of 180 countries from 1970-2007 for customs unions. GDPGROWTH is annual percentage growth rate of GDP at market prices based on constant local currency. RINTEREST is the lending interest rate adjusted for inflation as measured by the GDP deflator. INFLATION is the inflation measured by the consumer price index. OPENNESS

is the sum of exports and imports of goods and services measured as a share of gross domestic product. CURRENTACC Current account balance is the sum of net exports of goods, services, net income, and net current transfers. RGDPWORK is the real GDP per worker (I$ 1000 per worker (in 2005 Constant Prices US$). EUROZONE is a binary variable which is 1 if country i is member to Economic and Monetary Union (EMU) of European Union in time t. CEMAC is a binary variable which is 1 if country i is member to Economic and Monetary Community of Central Africa in time t. WAEMU is a binary variable which is 1 if country i is member to West African Economic and Monetary Union (WAEMU) in time t. DOLLAR_LTENDER is a binary variable which is 1 if country i is using dollar as legal tender. *, **, and *** represents statistical significance of 10 percent, 5 percent, and 1 percent, respectively. Standard error is given in parentheses. Degrees of freedom are included in parentheses for F-stat and Chi-square.

Table 11 reports the results on the impact of membership of CUs on net FDI (inflows-outflows) of countries. The coefficient on Eurozone is -3.96, which point to increased FDI outflows in comparison to FDI inflows in the region. The regression results for net FDI of CEMAC are robust, representing large investments in member countries in natural resources.

The membership in WAEMU may negatively affect the net FDI. The reason for this might be dependence on agriculture sector, lack of economic freedom and industrialization policies in these countries. Dollar is positive and insignificant. ECCA have significant and positive impact on the net FDIs of member countries, mainly due to tax incentives offered by these countries and opportunities in tourism sector.

4.7 Conclusions

In this chapter, I attempted to investigate the impact of trade agreements and currency unions on inflows, outflows and net FDI flows to 180 countries from 1970-2007. The regression analysis show that membership of WTO is significant and robust in all the regressions: inflows, outflows and net FDI which means that the decision to become the member of WTO increases all kinds of FDI i.e. inflows, outflows and net. On the whole, net FDI increases with the membership of WTO. Very interesting results are found for EU membership. Membership to EU has positive but insignificant effects on FDI inflow of members. On the other hand, it has a significant impact on the outflows, which results in a negative and highly

significant relationship with net FDI. It means that, on the whole, net FDI (inflows-outflows) decreases with the membership of EU and EU countries are net providers of capital. The study shows that CACM is insignificant and has a negative relationship with the FDI of its members can strongly increase FDI, while the influence on outflows is insignificant. Membership to Caricom suggest that FDI inflows and outflows both have negative and significant relationship with FDI suggesting trade substitutes FDI between the members. The results correspond with the increase in intra-regional trade which was "10 times higher in 1994 and 85 times higher in 1998" (Cernat 2002).

The empirical findings for WAEMU, CEMAC and SACU suggest there may be another reason for the negative and insignificant impact of Africa's RTAs. Countries in Africa are involved in more than one regional integration agreements, which is at different stage of integration (Yang and Gupta 2007). This may influence their objectives for economic development and weakens their will to prioritise and achieve some goals. Other obstacles in the way of results of regional integration are the increase of non-tariff barriers and a limited attention to intra-regional tariff reduction. The membership to SACU is disadvantageous for the countries due to its higher protection levels in terms of trade against the non-member countries (Yang and Gupta 2007).

Chapter 5
The Effects of Political Risk on Foreign Direct Investment (FDI): Evidence from OECD Countries

5.1 Introduction

A continuous increase in international capital transfers has been noticed in the post-Bretton Woods period. Markets are becoming more integrated due to trade and FDI openness. Relative to trade, FDI flows have increased over time. Governments are relaxing the restrictions for investment policies and implementing different strategies to motivate foreign investors to commit funds in their countries (Carkovic and Levine 2005). FDI brings the required funds and increased investments which in turn stimulate employment, production, consumption, savings and trade in the country. Multinational enterprises are associated with productivity growth/ spillovers by bringing new methods, technology, new industries, as well as marketing and managerial expertise. FDI is also explored as creating positive wage effects for the employees of local establishments, because international organisations offer relatively higher remuneration packages to their

employees (Tomohara and Takii 2011; Aitken et al. 1996). This whole process accelerates the economic development process in a country. However, it is said to be a reciprocal process where not only the actions of multinational enterprises affect the host country, but the policies of host government also significantly influence directly or indirectly the functioning (production, trade and investments activities) of MNEs (Spar 2009). FDI could be also sensitive to institutional environment and political system of a given country.

FDI is a long-term investment in fixed assets and disinvestment is not a usual process as compared to portfolio investments, which are short term investments and can easily be withdrawn from a country. Keeping in view the potential advantages of FDI, it is important to identify what brings foreign investors to some countries. In this chapter, I aim to analyse whether international investors are motivated by political atmosphere or situation of a country.

Due to visible importance of political risk for FDI investments, a large body of literature exists on the effects of both home and host country political risk. Tallman (1988), Grosse and Trevino (1996) and Thomas and Grosse (2001) found that home country political risk increases the FDI outflows to host country due to comparatively stable economic conditions in the latter.

The previous political risk literature mainly emphasized the issue of whether international investors have a preference for democratic government

(democratically elected leadership) in the host country. The earlier studies found mixed results. Oneal (1994) in his study on the effects of different regimes on US FDI outflows, analysed the concept that international investors undertake FDI in autocratic governments, as they are more supportive and beneficial for the MNEs in terms of investment policies and government subsidies relative to democratic governments and found insignificant effects. In support of this concept, Li and Resnick (2003) assert that autocratic governments could give assurance and help in alliance to cartel of international investors. For monetary benefits (bribes), these autocrats could help investors to achieve their objectives of market domination, even suppressing the voices of local businesses in the process. In an empirical study, their results were in harmony with their theoretical predictions, showing negative relationship of democracy with FDI.

However, Jakobsen and de Soysa (2006) argue that results of Li and Resnick (2003) study are vulnerable to the sample selection and the choice of modeling method. On the other hand, Jensen (2003) discusses those grounds which support the concept that democracy improves the confidence of international investors and credibility of that country. First, there is lower probability of unexpected or radical policy changes and reversals due to the existence of veto players. Second, to avoid the cost of losing political and electoral support, democratic leaders would try to keep their promises with international investors. The results of empirical study (with a large sample of countries) support his concept that international investors are motivated to

invest in democratic countries thus increasing their inward FDI. Choi and Samy (2008) suggest that the presence of veto players is more associated with the increase in inward FDI to democratic countries than the audience costs.

In this chapter, I analyse the relationship between inward FDI flows in the Organisation for Economic Co-operation and Development (OECD) countries and political factors which are linked to different forms of government and political spectrum. This study does not employ standard division into autocratic and democratic states, as these nations are very firm in their commitment to democratic system. Therefore, I explore more subtle diversities in political environments of these nations and examine if international investments are affected by these political factors. These differences are found to have important influence on investment decision making in terms of geographical distribution of FDI. The main reason to select OECD countries as a sample for the study is that most of the empirical literature on the political economy of the cross-border investments has focused on the characteristics of developing nations. This is despite the fact that according to World Bank (2011), 69.5% of all inward FDI inflows were channelled to OECD countries between 2000 and 2010. Further, this study benefited from the greater availability of reliable statistical information for these industrialized nations.

The chapter is structured as follows. In Section 2, I present literature review and discuss the association between political environment and FDI

inflows. In section 3, I report sources of data and summary statistics. In penultimate section, I present results along with the explanation of results. The final section concludes the chapter.

5.2 Literature Review and Hypothesis Development

Among other factors, government spending is a vital element of fiscal policy and is considered to have important implications for macroeconomic outcomes, such as inflation, unemployment and taxes, which subsequently affect businesses (domestic and international) and economic development of countries (see for instance Sims 1994; Laubach 2009). Government spending, if in excess, has negative impact on international businesses as it is said to decelerate economic growth (Landau 1983; Grier and Tullock 1989; Barro 1990) and crowd out private investments (Argimon et al. 1997). Therefore, budgetary discipline plays an important role in economic stability of host countries and attracting investors (Jensen 2003; Choi and Samy 2008).

This study attempts to analyse the concept from the viewpoint of previous studies by taking into consideration the developed nations. How do these factors affect inward FDI in developed countries? Oneal (1994) suggests that the military rule in the country dissuades FDI. This study examines the extent to which a government is funding military, which indicates the government's priorities and the current or on-going external

relations. International businesses would not like to invest in countries with political instability and risk of war.

The following two hypotheses will be tested:

Hypothesis 1: FDI is decreasing with more government spending

Hypothesis 2: Military expenditure are a bigger deterrent to FDI inflows compared to other types of government consumption

Generally, it can be imagined that international businesses have predilection for the particular political ideology in the case of economic systems, form of governments, or political spectrum (left, right or center) in the host country. According to Hibbs (1977), different political parties with varying set of beliefs and convictions have individual approaches to the political and economic policies of the country, which may have differing consequences for the nation. He described that low unemployment and high inflation policies are supported by left-wing parties. On the other hand, right-wing parties prefer low inflation and high unemployment combination.

When it comes to the US stock market, it becomes evident that investments may be influenced, to a certain extent, by the political ideologies of policy makers. Small capitalization stocks earned excessive stock market returns during Democratic governments compared to Republican administration (Johnson et al., 1999; Santa-Clara and Valkanov 2003). Investors could benefit by developing trading strategy on the basis of this intriguing stock market anomaly (Hensel and Ziemba 1995).

In the context of FDI, Pinto and Pinto (2008) develop a theoretical model which predicts a partisan cycles in cross-border investments. In particular, left-wing parties are assumed to promote or attract capital imports that employ more labour. On the contrary, right-wing governments encourage capital deepening FDI (Boubakri et al. 2009). Mudambi and Navarra (2003) conducted an empirical study that investigated how voters' electoral preferences affect the FDI inflows in the different regions of Italy. On the basis of their findings, they deduce that the FDI location decision of multinational enterprises consist of two phases. In the first phase, MNEs weigh up the firm-specific and location-specific factors, and then the assessment of political and other risk factors comes into play in the second stage.

Two earlier empirical studies assessing the impact of political orientation of the executive in a multi-country setting have opposite conclusions regarding the significance of the abovementioned subject. Schneider and Frey (1985) examined the influence of leftist executive as a dummy variable on FDI inflows, and found no significance in their sample. On the other hand, Jakobsen and de Soysa (2006), in a recent analysis, found positive and significant impact of the similar variable pointing to the possibility that pro-labor governments may attract FDI to meet their main objective of reducing the unemployment rate. The present study employs a different taxonomy of political ideology compared to that used in Schneider and Frey (1985) and Jakobsen and de Soysa (2006). Rather than using a

dichotomous classification of governments, right, left and center are used to represent the political affiliations of the groups in power. This kind of slight modification in explanatory variable assists in obtaining interesting results. In light of the foregoing discussion the following hypothesis is put forward:

Hypothesis 3: FDI inflows are a function of the political orientation of the executive

Another variable selected for the study is the form of government in the sample of countries. Out of the sample, almost all nations have parliamentary system except United States of America and South Korea, which use presidential system as a form of state governance. In presidential system, the president acts as authority, the head of state and head of government and is elected nationally. The president and legislature are elected separately in the system. On the other hand, parliamentary system consists of separation of power and responsibility; prime minister as head of government and president as head of state. The prime minister is usually the head of the elected party that either gets power automatically or is voted in by the parliament. The prime minister, as a chief executive along with the cabinet, is responsible for policy-making and policy implementation. The president has primarily ceremonial powers but during political or economic crisis may play an important role (Macasaquit 2006). Governments in parliamentary system could end their tenure through the vote of no-confidence by parliament or party vote. Due to a number of circumstances, elections may be called early (Cargill and Hutchison 1991; Bialkowski et al.

2008), which exacerbates the political risk. The methods of removal from office make parliamentary system more vulnerable and intensify the political risk.

As there is lack of empirical literature which examines the impact of political governance systems on FDI and location-specific decisions of foreign investors, and more research needs to be done in order to understand the effects of these systems on investors' decisions. While each of the systems has their pros and cons, this study aims to analyse the following statement:

Hypothesis 4: When choosing FDI location, MNEs are not indifferent to the system of government

Another important issue that has been analysed from different perspectives is the impact of political business cycles. In this study, I aim to examine how foreign investments are affected by election cycle of a country. In his seminal paper, Nordhaus (1975) reasoned that in an effort to stay in power and maintain public confidence, political parties may manipulate policy instruments. Rogoff (1990) alludes to the fact that before election, governments have tendency to step in the conspicuous projects and schemes to charm the public into re-electing them. Attracting and bringing more FDI in the country might be one of such tactics.

Earlier studies have found the effects of political business cycle on stock market returns. There have been some indications of the relationship between US stock market returns and the four-year presidential cycle (Herbst

and Slinkman 1984; Booth and Booth 2003). It can be said that individual investors seem to be impressed by the election campaign rhetoric. On the contrary, multinational enterprises are thought to use more formal ways to invest and are less affected by these temporary manipulations of economic conditions. Another important issue is the differing motives of incumbents and multinational enterprises. Therefore, it is observed that investment risk increases during election times (Bialkowski et al. 2008). It becomes complicated when MNEs negotiate investment agreements with the government officials who try to retain power. Problems may arise in the case when the office bearing political party is not elected again and the next government changes their economic policies and priorities about investments. These factors may discourage MNEs from making long-term investments in the host country. Further, Julio and Yook (2012) reveal that the total capital expenditure of companies is diminished in the election years. It would be interesting to see if the same applies to the current study. The topic of political business cycles has not received much attention in the FDI literature. Therefore, it is difficult to forecast precisely the results on theoretical grounds. On the other hand, there seems to be a real contrast between the objectives of foreign investors, who are interested to invest in countries with minimum political risk and incumbents, who make policy changes in order to maximize their chances of re-election and thereby create more political risk. Thus, there is a need to examine the impact of elections on FDI. This chapter aims to analyse the following statement:

Hypothesis 5: FDI inflows are influenced by the timing of elections

In relation to the timing of election, time period (how long a party remain in power) is also an important consideration for FDI. This might show the long term policies, interests and their implementation of various political parties regarding investments. In the sample of OECD, this variable takes particularly high values in Hungary, Czech Republic and Poland prior to the fall of communism and in Mexico before 2000, indicating that it is a good proxy for the lack of political competition. For good economic environment and economic development, citizens should be able to fully express their political preferences and hold incumbents accountable for their actions. In their empirical study, Besley et al. (2010) using panel data for US show that weak political competition is a serious obstruction to economic prosperity. It may also have an influence on the image of the country worldwide. This study tests the following hypothesis:

Hypothesis 6: Inward FDI is inversely related to the length of time that the party of the executive has stayed in office

There has been vigorous debate taking place on the relationship between democracy and FDI decisions of foreign investors (Li and Resnick 2003; Jensen 2003). It is important to stress that the current study uses a sample of OECD countries, where almost all of them fall into the category of democratic countries. Hence, the right question that arises here is how reputable are these democracies? Therefore, this study aims to analyse the age of big political parties. The number of years of existence of these

political parties will indicate the strength and tradition of democracies. Well-established democracy leaves little opportunity for fringe group to rule the country and brings more political stability. The political environment, if conducive, attracts more foreign investments. In a climate of ensuing political stability MNEs can apply lower discount rates at the project appraisal stage, which would generate higher investment levels. These considerations motivate the next hypothesis:

Hypothesis 7: Average age of the main parties in democratic countries is positively related to FDI

Then comes the point of the control exerted by the incumbents. The political parties in power gain good reputation when their decisions and policies do not take much time to implement. This is fairly uncomplicated when the controlling authority have a hold over all law making houses. When law-making houses are not controlled by the party of executive, the process of making decisions and policies may become slower due to ideological conflicts. Foreign investors do not enjoy this situation. Its postulated relationship with FDI can be formalized as follows:

Hypothesis 8: Ceteris paribus, MNEs direct more FDI to countries where the party of executive controls all houses with law-making powers

5.3 Empirical Model, Data and Estimation Methodology

In this study, I conduct an empirical analysis of the dataset of 33 OECD countries for the period of 1975 to 2009. Table 12 presents the names of OECD countries. Out of OECD members, Luxembourg was excluded from sample, as it was an extreme outlier. The pass-through capital (or capital in transit) by Resident Special Purpose Entities in Luxembourg are most probably the reason of the significantly distorted FDI statistics (OECD 2008).

Table 12 Sample of OECD countries for the analysis of the impact of political risk on FDI inflows

Australia	Japan
Austria	Korea
Belgium	Luxembourg
Canada	Mexico
Chile	Netherlands
Czech Republic	New Zealand
Denmark	Norway
Estonia	Poland
Finland	Portugal
France	Slovak Republic
Germany	Slovenia
Greece	Spain
Hungary	Sweden
Iceland	Switzerland
Ireland	Turkey
Israel	United Kingdom
Italy	United States

Source: OECD 2011

The data for this study have been collected from a variety of sources: Main Economic Indicators (OECD 2011), World Development Indicators (World Bank 2011), IDEA Voter Turnout Database (IDEA 2011), Database of Political Institutions 2010 (Beck et al. 2001), Election Guide (IFES 2011) and the Institutions and Elections Project Database (Regan et al. 2009). The political and control variables along with their exact definitions and sources are presented in Table 13.

Table 13 Variables used and Data Sources

Variables	Definitions	Data Sources
FDI_Inflow	Foreign direct investment, net inflows (% of GDP)	World Development Indicators
Government_Spending	General government final consumption expenditure (% of GDP)	World Development Indicators
Military_Expenditure	Military expenditure (% of GDP)	World Development Indicators
Non_Military_Expenditure	Derived variable equal to Government_Spending-Military_Expenditure	World Development Indicators
Right	Dummy variable. Takes a value of one when the party of the executive is conservative, Christian democratic, or right wing and zero otherwise.	Database of Political Institutions
Center	Dummy variable. Takes a value of one when the party of the executive is centrist and zero otherwise.	Database of Political Institutions
Presidential	Dummy variable. Takes a value of one for countries with presidential system and zero otherwise.	Database of Political Institutions
Elections	Dummy variable. Takes a value of one in years of executive elections and zero otherwise.	IDEA Voter Turnout Database, Election Guide, Institutions and Elections Project Database, Database of Political Institutions
Years_In_Power	Length of time that the party of executive has been in office (in years)	Database of Political Institutions
Party_Age	Average ages of the first government party, the second government party and first opposition party (in years)	Database of Political Institutions
All_Houses	Dummy variable. Takes a value of one when the party of the executive controls all houses with law-making power and zero otherwise	Database of Political Institutions
Openness	The sum of imports and exports	World Development

	of goods and services (% of GDP)	Indicators
GDP_Growth	GDP per capita growth based on constant local currency (annual %)	World Development Indicators
Inflation	Growth rate in Consumer Price Index (all items)	Main Economic Indicators
Market_Size	Natural logarithm of GDP (constant 2000 US$)	World Development Indicators

This study uses net FDI inflows expressed as a percentage of GDP as the dependent variable following the empirical work of Jensen (2003) and Ahlquist (2006). The practice of measuring dependent variable in terms of GDP improves the validity of statistical inferences as this method leads to stationary series. This study employed the Levin et al. (2002) panel unit root test to the *FDI_Inflow* variable to test the null hypothesis of a common unit root and rejected it. Individual unit root tests were also conducted by using Fisher-type ADF and PP tests (Maddala and Wu 1999; Choi 2001) which confirmed that separate unit roots were not found. Because of the absence of joint and individual unit root (stochastic trends), the selection of this dependent variable seems much better than other potential alternatives.

The selection of the control variables is done very carefully on the basis of literature (see for instance Busse and Hefeker 2007) and logical inferences. The first customary control variable is trade openness defined as the sum of imports and exports divided by GDP. The variable of GDP growth is used in this study keeping in mind the pro-cyclical nature of FDI. Further, to analyse the monetary discipline and its effects on FDI, the variable of inflation rate is included. As inflation may have adverse consequences for both national and international businesses in terms of taxation and interest rates. Inflation is expected to have negative relationship with FDI (Bengoa and Sanchez-Robles 2003). The variable of GDP is logged and captures the effects of market size. As among one of the important motives of FDI, market seeking FDIs (Behrman 1972; Dunning and Lundan 2008) have large share of

international investments. Large markets show and provide the potential for consumption, large economies of scale and spill over effects. Chakrabarti (2001) and Tuman and Emmer (1999) attribute the geographical distribution of FDI to market size.

Table 14 Summary Statistics

Variable	Number of observations	Mean	Standard deviation	25th Percentile	Median	75th Percentile
FDI_Inflow	1046	2.5400	5.2626	0.4247	1.2262	2.8814
Government_Spending	1086	18.5692	5.2495	14.9419	18.8603	21.6833
Military_Expenditure	688	2.2314	1.6992	1.3058	1.8717	2.5259
Non_Military_Expenditure	684	16.3609	4.6982	12.8028	17.0976	19.2528
Right	1188	0.4599	0.4986	0.0000	0.0000	1.0000
Center	1188	0.0878	0.2832	0.0000	0.0000	0.0000
Presidential	1188	0.1496	0.3568	0.0000	0.0000	0.0000
Elections	1136	0.2667	0.4424	0.0000	0.0000	1.0000
Years_In_Power	1026	9.0702	11.8453	2.0000	5.0000	9.0000
Party_Age	1010	52.6550	35.0558	23.5417	51.6250	72.6667
All_Houses	1071	0.2810	0.4497	0.0000	0.0000	1.0000
Openness	1079	70.0134	34.4076	47.8407	63.0941	82.5233
GDP_Growth	1091	2.0341	3.2083	0.5922	2.2106	3.7589
Inflation	1102	13.5132	52.1602	2.2125	4.1785	10.1271
Market_Size	1128	25.9577	1.5962	25.0054	25.8651	26.9400

Table 14 presents the summary statistics for the variables used in the study. The net FDI inflow for the sample of OECD countries for the period of 1975 to 2009 is on average 2.54 percentage of GDP. Governments consume on average 18 percent of GDP, out of which around 2 percent is spent on military and 16 percent on non-military expenditure. The proportion of time that an executive party was right wing, conservative or Christian democratic was almost 46 percent relative to centrist executive of around 9 percent. The means of both Presidential and *Party_Age* variables testify to the fact that the sample consists of deeply entrenched democracies, and that the parliamentary system is the most dominant political arrangement. On average, executives were elected every four years and their parties stayed in power for about nine years. The mean of the variable *Years-In-Power* is relatively high most probably due to the high values recorded in countries of Eastern Europe before the fall of communism and in Mexico prior to 2000. Lastly, parties of the executives frequently did not control all houses with law-making power.

5.4 Empirical Results

This chapter employs two estimation methods for modeling the FDI inflows, namely the pooled OLS and the panel regressions. Fixed effect panel models used in this study are superior on theoretical grounds, because they control for time-invariant heterogeneity across countries and are relatively robust to omitted variable bias (Chamberlain 1978; Hausman and Taylor 1981). The pooled Ordinary Least Squares models can be efficiently used to

estimate the robustness of results. The results of both methods are presented in separate tables. As can be seen in Table 15, the Breusch-Pagan-Godfrey tests (Breusch and Pagan 1979; Godfrey 1978) reject the null hypothesis of homoskedasticity. This study employs White (1980) heteroskedasticity-consistent standard errors in combination with the pooled OLS and GLS cross-section weights in the context of panel estimation. The findings of Hausman (1978) tests in Table 16 endorse the use of fixed effects model and signify that random effect model may lack consistency. Further, the assumption of redundant fixed effects is strongly rejected; this gives a good rationale for the use of estimation methods in the study.

Table 15 Determinants of FDI inflows; pooled OLS estimation

Variables	(1)	(2)
Intercept	-7.1685 (4.6045)	-11.0721 (6.9489)
Government_Spending	-0.0868** (0.0388)	
Military_Expenditure		-0.1940*** (0.0547)
Non_Military_Expenditure		-0.0650 (0.0622)
Right	0.0598 (0.3016)	0.3755 (0.4340)
Center	-0.9675 (0.6107)	-2.3027*** (0.7506)
Presidential	0.5908** (0.2813)	0.6238 (0.3847)
Elections	0.2511 (0.3362)	0.3769
Years_In_Power	-0.0117 (0.0082)	-0.0328*** (0.0124)
Party_Age	0.0110*** (0.0033)	0.0117*** (0.0038)
All_Houses	0.3793** (0.1658)	0.2151 (0.2264)
Openness	0.0693*** (0.0138)	0.0781*** (0.0175)
GDP_Growth	0.0555 (0.0465)	0.0970 (0.0657)
Inflation	-0.0113*** (0.0035)	-0.0099 (0.0077)
Market_Size	0.2221 (0.1627)	0.3539 (0.2307)
Number of Observations	900	608
Adj.R-squared	0.1561	0.1736
F-statistic	14.8586	10.8101
***p*-Value**	0.0000	0.0000
Breusch-Pagan-Godfrey test	2.2556	1.8201
***p*-Value**	0.0086	0.0370

Note: White (1980) heteroskedasticity-consistent standard errors are given in parentheses.

***, **,*denote statistical significance at 1%, 5%, 10%, respectively

Table 16 Determinants of FDI inflows; Fixed Effect Panel Estimation

Variables	(1)	(2)
Government_Spending	-0.1593*** (0.0306)	
Military_Expenditure		-0.7388*** (0.1284)
Non_Military_Expenditure		-0.2727*** (0.0515)
Right	-0.0960 (0.1072)	-0.1037 (0.1354)
Center	-0.4771*** (0.1417)	-0.3412 (0.2489)
Elections	0.0638 (0.0929)	0.1268 (0.1125)
Years_In_Power	-0.0043 (0.0045)	-0.0236*** (0.0068)
Party_Age	0.0095*** (0.0032)	0.0129** (0.0037)
All_Houses	0.1498 (0.1259)	0.3301** (0.1336)
Openness	0.0475*** (0.0065)	0.0585*** (0.0107)
GDP_Growth	0.0423** (0.0184)	0.0193 (0.0235)
Inflation	-0.0015 (0.0015)	-0.0016 (0.0039)
Market_Size	1.8996*** (0.1992)	-0.2025 (0.5740)
Number of Observations	900	608
Adj. R-squared	0.4571	0.5030
F-statistic	19.4590	15.6272
***p*-Value**	0.0000	0.0000
Hausman test	26.5613	22.5440
p-Value	0.0054	0.0319
Redundant Fixed Effects Test	14.7884	11.4859
***p*-Value**	0.0000	0.0000

Note: This table presents coefficients from the fixed effect panels estimated using a feasible GLS method, which takes account of heteroskedasticity by applying cross-section weights.

The adjusted R-square measure is weighted and the standard errors of the coefficients are given in parentheses. To conserve space, fixed effects are not reported. Results of Hausman (1978) test for the orthogonality of random effects and the regressors are shown along the test for the redundant fixed effects. ***, **, * denote statistical significance at 1%, 5% and 10%, respectively.

Table 15 and 16 demonstrate the robust effects of political factors on FDI inflows using pooled OLS and fixed effect panel estimation methods respectively. The increase in government consumption decreases FDI inflows most probably because of its consequences on the general taxation. These findings are in harmony with the results of Jensen (2003) and Choi and Samy (2008). However, it is important to mention that all the categories of government consumption are not considered equally unfavourable by foreign investors. The coefficient of military expenditure variable is recorded three times larger in absolute value compared to other types of government consumption. This points to the notion that MNEs prefer to invest in those countries where much of the spending are constructive, have positive spillover effect for the investors, society and economy.

Among the three political orientations, leftism (of executive) is used as a benchmark for this study. The coefficients on *Center* variable are negative in all specifications and reach statistically significant values in two equations. Pinto and Pinto (2008) explain the differing policies of right-wing and left-wing parties regarding FDI inflows and assert that right-wing or pro-capital parties in power prefer those foreign investments which replace labor with capital. On the other hand, leftist support those FDIs which increase number of jobs in the country. The strategies of centerist parties regarding FDI are more ambiguous. Therefore, their vague economic ideologies may make their political decisions and preferences volatile and unpredictable and

thus increase political risk. This kind of political risk might be seen in the results.

The panel regressions do not include presidential variable for the analysis due to the expected high level of collinearity with the fixed effects. Among the types of government systems in the sample countries, presidential system appears to attract 0.6% of GDP more FDI inflows at the significance level of 5% and almost 10% in Table 15 using pooled OLS regressions. This shows the inclination of foreign investors towards the division of power which makes these important institutions of the presidential system (executive, legislative and judiciary) more responsible and accountable to each other. Another advantage of presidential system for international investors is that they do not need to worry about complicated political arrangements such as coalitions.

This study finds no evidence in favour of the fifth hypothesis and concludes that the timing of elections appears to have no effects on FDI inflows. In order to obtain immediate short-term economic transformation which supports or improves the image of political party in power, the incumbents attempt to attract more FDI inflows in the country before elections. Conversely, foreign investors will not be willing to make sizeable long-term investments in those countries where elections increase uncertainty and political risk. Both of these forces seem to counterbalance reciprocally, which might be the reason for statistical insignificance of the *Elections* variable.

The results related to the *Years-in-Power* variable are much convincing. This variable measures the lack of political rivalry in the country and results suggest that it has an inverse relationship with FDI inflows. Political competition might be considered as a means of controlling exploitation of power and making economic environment conducive for investments in the country. Therefore, the results for this hypothesis are consistent with the intuition and signify that positive democratic practices are critical for country's international reputation.

Further, these inferences are supported by the observation that countries with well-established democratic systems are able to attract comparatively more FDI inflows. The coefficients on *Party-Age* variable (indicating average ages of the first government party, the second government party and the first opposition party) are highly significant at 1% in all regressions. This implies that the more experienced the party is in power, the more capable the country is in attracting FDI inflows. The results show that there is around 0.1% increase in annual FDI inflows with an additional ten year experience. The age of the parties creates stable political situation in a country for two reasons. First, it is implausible that factions favouring radical views could come in power. Second, international investors find economic environment more secure and less risky for investments when there are only small information asymmetries between government and investors resulting in increased FDIs.

As is quite clear from the results, international investors prefer confidence and authority in decision making by government. The coefficients on the variable *All_Houses* (which denotes the case when the party of the executive controls all houses with law-making power) are all positive and statistically significant in half of the specifications. When the ruling party has the control and is involved in all the processes of policy making and implementation, the risk of long-standing deadlocks and implementation delays is reduced.

Finally, the signs of the coefficients on the control variables reinforce *a priori* predictions in just about all regressions. There is strong positive relationship between openness and FDI inflows. The results support the view that both FDI and trade are complements (for details see Mundell (1957) and Markusen (1983)). The more open a country is to trade, the more FDI it attracts. Direct investments are likely to decrease during high inflation episodes and economic slowdown or recession phases. This study corroborates the gravity model conclusion that FDI tend to be larger in countries with large market size.

On the whole, the robust results of the study and the *p*-values associated with the *F*-statistics for the regressions point towards the importance and strong impact of political factors on location-specific decisions of international investors. This study has found supporting evidence for almost all the theoretical predictions apart from Hypothesis 5. It seems that national elections do not have an effect on FDI inflows, which might be

due to the differing interests of politicians and international investors. Incumbents emphasize the economic development through quick-fix policies (attracting FDI is one of those ways) to get re-elected. On the other hand, foreign investors are probably more anxious of increased political risk during election periods.

5.5 Conclusions

In this chapter, the focal point was the investigation of political economy of FDI in the post-Bretton Woods era. Earlier empirical literature mainly laid emphasis on the relationship between democracy and direct investments. This study intended to examine more delicate political aspects. As the sample for the study consists of fully democratic OECD countries more multifaceted and intricate political factors were analysed, as a simple division into democratic/ autocratic systems seems inappropriate here. The findings indicate an important influence of subtle differences of political systems on the location-specific decisions of multinationals.

Excessively large government consumption can be deemed as a hindrance in attracting FDI, particularly when huge outlays consist of military or defence funding. Although, international investors on average do not show preference for left or right wing parties in power, they have different sentiment towards centrists. Due to their perplexed stance on political spectrum, their policies are difficult to predict and investors have less confidence to commit large investments in these countries. In order to

make their regime more appealing and in order to assure investors, centrists have to make their strategies more predictable. The situation is similar with the coalition governments in case of parliamentary system. Consequently, investors seem to prefer presidential form of government. The results of the study point to the fact that in order to make a country's environment more welcoming to international investors, political uncertainty (and insecurity associated with it) should be eliminated by clearly publicizing ideologies, goals and objectives of the party/ coalition.

The timing of executive elections did not have much influence on FDI in the country. On the other hand, a political party's long-standing stay in power negatively affected FDIs indicating lack of effective political competition. Countries with long tradition of democracy attracted more FDI. The age of main parties in the country had strong effect on direct investments, as it gives the opportunity to investors to know about their standpoint on different policies and reduces political uncertainty. Lastly, investors were more inclined towards those countries where party of the executive controls all houses with law-making powers, as this eliminates the hurdles and speeds up the implementation of policies.

Chapter 6
The Eclectic Paradigm and Foreign Direct Investment (FDI)

6.1 Introduction

In the field of international business, John Dunning's eclectic paradigm is the most widely recognized and used theory, which serves as an important mechanism for the analysis of foreign direct investments (FDI). The eclectic paradigm is an all-embracing analytical framework that encompasses diverse theories and contributes towards the understanding of patterns, trends, and determinants of FDI. The main idea of eclectic paradigm is that in order to invest abroad, a firm ought to have important advantages in terms of ownership, location and internalization (Dunning 1977, 1980, 1993, 2000a, 2001). Ownership-specific advantages could be competitive in nature and firms could enjoy monopoly power, "possession of a bundle of scarce, unique and sustainable resources and capabilities, which essentially reflect the superior technical efficiency of a particular firm relative to those of its competitors" (Dunning 2000a:168). Location-specific advantages are the "immobile, natural or created endowments" (Dunning 2000a:164) which become an incentive to invest in a particular country. Last but not the least, the internalization advantage gives international investors incentives to

engage in foreign investment activities rather than franchising or licensing (Dunning 2000a).

A substantial body of empirical literature documents the positive spillovers of FDI to host nations and their economies. Such externalities can come in the form of an increase in national income, savings, financial resources (significant means of funding), higher employment rate, new technology and managerial know-how, improvements in human resources, increases in competition and economic development (Chowdhury and Mavrotas 2006; Moghaddam and Redzuan 2012; Alfaro et al. 2004). Another important advantage of FDI is that it is considered to be less risky in the long run than other forms of investments due to the fixed and long-term nature of incentives (Nunnenkamp 2001). Increase in FDI inflows signals towards liberalization of government policies and improved investment climate.

The main objective of the chapter is to empirically examine the impact of three important aspects of Eclectic Paradigm that is ownership, location and internalization on FDI inflows by using different variables for each sub-paradigm. This study examines the relevant variables over the last couple of decades for 196 countries. The reason for analysing FDIs in our sample is that during this era notable changes in global, economic and political arena took place. Recent decades witnessed a rapid globalization, market liberalization, technological developments in production processes, means of communications and distribution systems and growth in international investments worldwide (Dunning 1996).

This chapter is divided into five sections. The next section explains the relevant FDI determinants in connection with OLI sub-paradigms and the main hypotheses for empirical analysis. The following section describes the data and methodology used for the study. Section 5.4 discusses the estimation results. Conclusions of the study are drawn in the final section.

6.2 Literature Review and Hypothesis Development for the Determinants of OLI Paradigm

This section describes the hypothesized relationship between dependent and independent variables and their expected directions on the basis of the existing literature.

6.2.1 Ownership

Ownership advantages are classified into asset ownership advantages, transactional ownership advantages (Dunning 1981a; Dunning and Rugman 1985), and institutional assets advantages (Dunning and Lundan 2008). First, asset ownership advantages comprise of the imperfect competition and monopolistic benefits firms enjoy, such as economies of scale, advanced technology, product differentiation, distribution networks, and privileged access to financial capital. The product-specific tangible assets include property and equipment. Ownership intangible assets of the firms can be analysed through intellectual property rights variables such as copyrights,

trademarks and patents (da Silva Lopes 2010; Lundan 2010). Second, transaction ownership advantages are efficiency benefits which multi-plant firms acquire during their interaction with local or international plants. These include benefits of common governance, exclusive access to resources, knowledge and relevant markets, capability of organizing and synchronizing value-added activities at various remote plants, competence of obtaining profits through product diversification and reducing transaction costs to the minimum. Lastly, institutional assets advantages imply the organizational environment, culture, rules and regulations, codes of conduct, human resource management policies such as incentive measures and performance appraisal systems (da Silva Lopes 2010).

This study uses trademark to examine the impact of asset ownership advantage i.e. brand name as a valuable intangible asset which differentiates the products of Multinational Corporation from other competitors. The literature on the effects of ownership variable (trademark) on FDI inflows is sparse. This study presents an effort to test ownership pillar related to the eclectic paradigm. Brands assure consumers about the consistent high quality of product in a way that build strong customer confidence and loyalty for future rapid decisions for purchase of branded product in comparison to other alternatives (de Chernatony and McWilliam 1989). Dawar and Parker (1994) in their empirical study report that consumers consider brand name first when purchasing a product, price and physical appearance of the product comes as a secondary consideration.

Multinational companies that have strong brands such as Apple, Coca Cola, Nike and adidas have competitive advantages of operation over the local businesses. People believe that they offer better quality and also become the symbol of status. This may be an important advantage in terms of cross border investments. Alashban et al. (2002) find that international businesses with standardized brand names have the benefits of cost saving (due to economies of scale advantages and decrease in advertising costs) and increase in sales volumes due to good consumer perception about the product. Therefore, for multinational enterprises, the decision of entering new markets may be beneficial from both consumer and business perspective.

Hypothesis 1: FDI inflows are a function of the ownership advantages of MNEs, which represent valuable international brand.

6.2.2 Location

Location-specific variables consist of those country specific aspects, which reflect the macroeconomic environment of the host nations. These variables are the indicators of financial stability and economic prosperity. Openness to trade and GDP growth are among the most commonly investigated gauges for the examination of suitability of location (for detailed studies on the determinants of FDI see Blonigen (2005), Blonigen and Piger (2011), Tsai (1994), Chakrabarti (2001) and Asiedu (2002)). The examination of the degree of openness helps in understanding whether a country's approach towards foreign investors is welcoming. Trade liberalization

(imports plus exports divided by GDP) is the most widely used measure of openness in empirical studies (Buckley et al. 2007; Yih Yun Yang et al. 2000; Keller et al. 2007; Asiedu 2002; Asiedu and Esfahani 2001; Asiedu and Lien 2011). Trade liberalization is considered to have a significant impact on FDI in terms of the nature of foreign investments in mostly tradable sector (Chakrabarti 2001). This study intends to verify whether FDI indeed has a positive and direct relationship with the degree of trade openness in the host economy, as high degree of openness implies more investment inflows.

An increase in the host country market size also opens up greater possibilities for foreign investors to effectively utilize available resources and take advantage of the economies of scale and scope (Buckley et al. 2007). The literature on the relationship between FDI and market growth rate (Chakrabarti 2001) confirms their positive association, as market growth shows increase in demand which attracts market seeking horizontal FDI. On the other hand, slow growing economies offer less chances of earning sizeable profits (Buckley et al. 2007). The growth in economy is expected to significantly encourage inward market seeking foreign investments. High GDP growth also implies strong domestic demand for products that the investors want to produce and future market potential (Noorbakhsh et al. 2001; Asiedu and Esfahani 2001). Banga (2003) found that economic growth rate plays an important role for both developing and developing countries.

The empirical studies on FDI inflows generally examine the impact of availability of natural resources by using variables such as the share of fuel

and oil in total exports (Asiedu and Esfahani 2001; Asiedu and Lien 2011; Abbott et al. 2012) and ratio of ore and metal exports as a percentage of merchandise exports (Allard 2012). This study analyses this issue from a different perspective. Lack of industrial (primary or intermediate) resources in the host country might be analysed by FDI investors in order to avoid the future perils of productions. This variable is proxied by the ratio of ore and metal imports scaled by merchandise imports (Buckley et al. 2007). Therefore, FDI is expected to have negative association with the host country imports of resources, as unavailability of important industrial inputs may increase the production costs or even could be the reason of business closure. According to World Bank (2012), this variable includes important industrial natural resource trade items, which are part of the Standard International Trade Classification (SITC) 2-digit sections 27 (crude fertilizers and minerals), 28 (Metalliferous ores and metal scrap); and 68 (non-ferrous metals such as copper, silver, aluminium, platinum, zinc, lead) (for more details of classifications see United Nations Statistics Division 2012).

Borrowing is a very important source of financing for both home and international businesses. The availability of financial resources (domestic credit to private sector as a share of national output) in host country could potentially have a huge impact on FDI inflows in terms of financing working capital. Ease of access to domestic credit offers a great facility and encouragement to international investors, especially in low and middle income countries (Oshikoya 1994). Funding resources falling under the

umbrella of domestic credit include trade credits, loans, debt securities and accounts receivables. They are also considered as efficient monetary policy instruments used to control credit availability in order to facilitate or restrict the private investments in the country (Blejer and Khan 1984). This study intends to use this variable as an indicator of financial liberalization proxied to measure financial depth of host country (similar measure has also been used by Noorbakhsh et al. 2001; Root and Ahmed 1979).

Gross capital formation is used to measure the impact of government spending on the development of infrastructure facilities (such as land improvements, roads, railways, availability of technology in the country) and the inventories held by firms for immediate use. Gross capital formation represents the spending on fixed assets in the country. These kinds of outlays are expected to have positive relationship with FDI inflows, as improved infrastructure may attract more long-term foreign investments. Earlier studies (Lipsey 2000; Asiedu and Lien 2011) used the variable of gross fixed capital formation for the examination of the relationship between FDI and government spending on infrastructure development.

Government consumption represents non-investment government expenditure, which incur in the process of purchase of goods and services and national defence expenditure. Government consumption is a very sensitive issue and, if in excess, it could slow down the rate of economic growth in the economy (Landau 1983; Grier and Tullock 1989; Barro 1990). Excessive public spending will also lead to tax increases in the future. For these

reasons, bloated government consumption may be unwelcomed by international investors. According to Asiedu (2002), government consumption also represents the size of the government, which if larger deters FDIs.

Finally, this study analyses the impact of educational attainment on FDI inflows, which is becoming an important locational macroeconomic variable for the study of the impact of skill availability on FDI inflows in countries. Plentiful and capable human capital attracts more FDIs. The variable of education is expected to have positive relationship with FDI inflows, as it represents the skilled and unskilled created asset of the country (Jensen 2003; Noorbakhsh et al. 2001). Faria and Mauro (2004) Keller et al. (2007) found positive and significant effects of primary school education on FDI inflows. Globerman and Shapiro (2002) examine the impact of education on FDI inflows by using an index of primary, secondary and tertiary school enrolment and found the variable highly significant.

6.2.3 Internalization

To examine institutional aspects of FDI, this study uses the variables of legal origin. The legal environment has the potential to be a decisive factor for an investor who is contemplating whether to engage in direct investment or whether to franchise.

6.2.4 Legal Origin

In the process of international investments, legal environment of the host country may play a significant role. The concept of investment friendliness, to a certain extent, involves a code of laws which characterize investment rights and the protection of those rights in the host country (La Porta et al. 1996). The important question here is whether direct investors in a country with a certain legal origin have the same privileges and rights as investors in another country with different origin?

The extent to which investors receive legal protection of their rights and efficiency of law enforcement in the host country establishes the confidence (La Porta et al. 1996) and supports improved performance of bond and stock markets (Levine 1998:597). These types of positive changes affect the decisions of international investors and determine their choice of investment location. There is considerable amount of literature available on the relationship between origin of legal rules or systems and stock markets (Roe 2006). However, only a very limited literature is available on the relationship between FDI and legal origin (Busse and Groizard 2008). The data for legal origin variables is taken from LaPorta, Lopez-de-Silanes, Shleifer, and Vishny (LLSV) (1997, 1998). The data on the legal systems is available for forty-nine countries. According to LaPorta, Lopez-de-Silanes, Shleifer, and Vishny (1997, 1998), nations can be analysed from the perspective of the legal system they follow (English, French, German and Scandinavian), which is often a result of occupation or colonization.

In this chapter, I aim to examine whether legal origin and the effective enforcement of investment rights account for the direct investment flows. The English legal system or common laws were mainly developed from the decisions of judges over centuries. On the contrary, French, German and Scandinavian legal systems are founded on civil law tradition, which is codified (Levine 1998:602). In the civil law tradition, the laws consist of comprehensive, constantly updated legal codes that enumerate all justiciable disputes, appropriate processes and the apposite penalty or sanction for every crime in keeping with the types of law i.e. substantive, procedural or penal law.

It is the duty of the judge then to examine the credible evidence and to make judicial decision according to due process of law. Legal scholars and legislators are responsible for the formation and progression of codes of law. Civil law is based upon Roman law, which was compiled in the sixth century. Gradually, countries formed their individual legal codes i.e. German, French and Scandinavian legal systems. Further, colonization (as a result of invasions) helped the spread of these legal systems worldwide (Levine 1998). According to Roe (2006), common law traditions are shown in studies to provide more protection to foreign shareholders in comparison to civil law. This partially, justifies why some countries have economically and financially sound capital markets. Thus, these studies report and show countries with common laws are significantly better than civil for the

development of the country. Roe (2006), in a convincing manner, criticizes such studies, which asperse the image of civil law tradition.

LLSV (1998) have reported the differences in the implications of these systems. In terms of law and contract enforcement, Scandinavian and German legal systems were leaders, while the French legal tradition countries were found to be those with the lowest quality of contract enforcements and rights of creditors. On the other hand, rights of creditors are much more respected in countries following common law tradition as compared to German, Scandinavian and French origin (Levine 1998). This study uses the data of 48 countries for the analysis of legal origin due to the unavailability of FDI data for the country of Taiwan. The list of countries using French, German, English and Scandinavian legal origins is given in Table 17.

Table 17 List of countries belonging to English, French, German and Scandinavian legal origin

English legal origin	French legal origin	German legal origin	Scandinavian legal origin
Australia	Argentina	Austria	Denmark
Canada	Belgium	Germany	Finland
Hong Kong	Brazil	Japan	Norway
India	Chile	South Korea	Sweden
Ireland	Columbia	Switzerland	
Israel	Ecuador	Taiwan	
Kenya	Egypt		
Malaysia	France		
New Zealand	Greece		
Nigeria	Indonesia		
Pakistan	Italy		
Singapore	Jordon		
South Africa	Mexico		
Sri Lanka	Netherlands		
Thailand	Peru		
United Kingdom	Philippines		
United States	Portugal		
Zimbabwe	Spain		
	Turkey		
	Uruguay		
	Venezuela		

Source (La Porta et al. 1998).

Note: My study includes the sample of 48 (excluding Taiwan due to unavailability of FDI data given in the above table, which makes total available sample of 49 countries).

6.3 Empirical Model, Data and Estimation Methodology

This section briefly describes the empirical model, data sources used for this study and summary statistics. In this chapter, I undertake an empirical examination of multi-country model with data from a sample of 196 countries for the period of 1970–2009. The variables of eclectic paradigm are tested first with pooled OLS estimation method and then with panel data analysis by using fixed-effects regressions. Panel data method is very useful for obtaining more efficient results due to increased sample variability and degrees of freedom compared to cross-section or time-series data. The use of fixed effects panel estimation helps in controlling differences between countries which are not time-varying and not directly observable. Fixed effect panel estimation is robust to omitted variable bias (Hsiao 2006; Noorbakhsh et al. 2001).

Following the hypotheses summarized in the previous section, potential explanatory variables include growth rate of economy, openness to trade, government consumption expenditure, gross capital formation, natural resource imports, domestic credit, legal origins, educational attainment, and trademarks registered. This study uses the dependent variable of FDI inflows as percentage of GDP to show the direct investment flows scaled by the size of the economy.

Various sources have been used for data collection: World Development Indicators (World Bank 2011), Penn World Tables PWT 7.0, La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998). The variables employed (main and control) are reported alongside their exact definitions and sources in Table 18.

Table 18 Definitions and sources of variables

Variables	Definitions	Data Sources
FDI_Inflows	Net inflows of foreign direct Investment as a percentage of GDP	World Development Indicators. The World Bank (2011)
GDP_Growth	Annual percentage growth rate of GDP at market prices based on constant local currency.	World Development Indicators. The World Bank (2011)
Openness	Openness to trade at Current Prices (%)	Penn World Tables PWT 7.0
Gov_consumption	General government final consumption expenditure (% of GDP)	World Development Indicators. The World Bank (2011)
Capital_ formation	Gross capital formation % of GDP	World Development Indicators. The World Bank (2011)
Resource_imports	Ores and metals imports (% of merchandise imports)	World Development Indicators. The World Bank (2011)
Domestic_credit	Domestic credit to private sector (% of GDP)	World Development Indicators. The World Bank (2011)
English	Binary variable that is equal to one if the legal origin is common law, and zero otherwise	La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998)
French	Dummy variable that is equal to one if the legal origin is French, and zero otherwise	La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998)
German	Binary variable that is equal to one if the legal origin is German, and zero otherwise	La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998)
Scandinavian	Binary variable that is equal to one if the legal origin is Scandinavian, and zero otherwise	La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998)
Education	Gross Primary School Enrollment	World Development Indicators. The World Bank (2011)
Trademark	Total trademark applications divided by total population and multiplied by 1000.	World Development Indicators. The World Bank (2011)

Table 19 Summary statistics

Variables	Number of observations	Mean	Standard deviation	25th Percentile	Median	75th Percentile
FDI_inflows	5878	3.8673	18.1716	0.3177	1.3109	3.7615
GDP_Growth	7368	3.8480	6.3869	1.3879	3.9887	6.4956
Openness	7919	78.1596	49.7272	44.2750	68.0000	102.4650
Gov_consumption	6916	15.9720	6.8800	10.9881	15.0984	19.4580
Capital_formation	6829	22.6494	8.7804	17.3769	21.9092	26.9219
Resource_imports	5559	2.3852	2.1200	1.0095	1.7744	3.1484
Domestic_credit	6774	40.8060	236.9759	13.6590	25.3909	47.2677
English	2400	0.3750	0.4842	0.0000	0.0000	1.0000
French	2400	0.4375	0.4962	0.0000	0.0000	1.0000
German	2400	0.1042	0.3055	0.0000	0.0000	0.0000
Scandinavian	2400	0.0833	0.2764	0.0000	0.0000	0.0000
Education	5805	95.5682	24.6193	89.9256	100.7455	108.5202
Trademark	4462	0.9204	1.5238	0.1176	0.4960	1.1445

Table 19 shows the summary statistics for the different variables representing the three pillars of Eclectic Paradigm for the sample of 196 countries for the period of 1970-2009. The net FDI inflows for the sample are on average 3.87 percentage of GDP per annum. Government consumption is found to be on average 16% of GDP. Table 19 shows a good average growth rate of 3.85% for the sample economies. Trade openness, representing the trade liberalization policies is 78%, which illustrate the countries' approach towards promotion of free trade.

Domestic_credit, on average, is approximately 41% of the available funds, which implies that private sector has reasonably good access to capital resources in sample countries. *Resource_imports* show ores and metals imports mostly used as input in industrial production processes account, on average, for 2.39% of merchandise imports to the sample countries. This result shows that sample countries do not import ores and metals in large quantities, attesting to the fact that these countries on average are relatively self-sufficient or rich in industrial resources and international investors have access to the required inputs without mobilizing a great deal of effort.

The mean of *Capital_formation* implies that the fixed assets of country account for about 23% of GDP, which helps in improving location-specific factors and possibly increase direct investments. Education variable indicates that about 96% of the population among the sample countries have basic reading, writing and mathematics skills, along with introductory or fundamental concepts of subjects (art, geography, history, music, natural

science and social science). There are about 920 trademarks registered per 1,000,000 people over the sample period.

Out of the 48 countries belonging to different legal origins, approximately 38% are using English legal system (common law tradition). Around 44% of countries follow the French legal origin, which indicates that the maximum numbers of countries are of French legal origin. Among the remaining legal systems, German and Scandinavian account for 10% and 8% respectively. Table 20 presents the names of sample countries.

Table 20 Sample of countries

Sample of 196 countries			
Afghanistan	Dominican	Macao Chi –R.P.	Sierra Leone
Albania	Republic	Macedonia	Singapore
Algeria	Ecuador	Madagascar	Slovak
Angola	Egypt	Malawi	Republic
Antigua and Barbuda	El Salvador	Malaysia	Slovenia
Argentina	Equatorial Guinea	Maldives	Small states
Armenia	Eritrea	Mali	Solomon
Aruba	Estonia	Malta	Islands
Australia	Ethiopia	Marshall Islands	Somalia
Austria	Fiji	Mauritania	South Africa
Azerbaijan	Finland	Mauritius	Spain
Bahamas	France	Mexico	Sri Lanka
Bahrain	Gabon	Micronesia, Fed.	Saint Kitts and
Bangladesh	Gambia	Sts.	Nevis
Barbados	Georgia	Moldova	Saint Lucia
Belarus	Germany	Mongolia	Saint Vincent
Belgium	Ghana	Montenegro	& Grenadines
Belize	Greece	Morocco	Sudan
Benin	Grenada	Mozambique	Suriname
Bermuda	Guatemala	Namibia	Swaziland
Bhutan	Guinea-Bissau	Nepal	Sweden
Bolivia	Guinea	Netherlands	Switzerland
Bosnia &	Guyana	New Caledonia	Syrian Arab
Herzegovina	Haiti	New Zealand	Republic
Botswana	Honduras	Nicaragua	Tajikistan
Brazil	Hong Kong Chi	Nigeria	Tanzania
Brunei Darussalam	Hungary	Niger	Thailand
Bulgaria	Iceland	Norway	Timor-Leste
Burkina Faso	India	Oman	Togo
Burundi	Indonesia	Other small states	Tonga
Cambodia	Iran	Pacific island	Trinidad and
Cameroon	Iraq	small states	Tobago
Canada	Ireland	Pakistan	Tunisia
Cape Verde	Israel	Palau	Turkey
Caribbean small	Italy	Panama	Turkmenistan
states	Jamaica	Papua New	Tuvalu
Central African	Japan	Guinea	Uganda
Republic	Jordan	Paraguay	Ukraine
Chad	Kazakhstan	Peru	United Arab
Chile	Kenya	Philippines	emirates
China	Kiribati	Poland	United
Colombia	Korea Rep	Portugal	Kingdom
Comoros	Kosovo	Qatar	United States
Congo Demo Rep	Kuwait	Romania	Uruguay
Congo Rep	Kyrgyz Republic	Russia	Uzbekistan
Costa Rica	Lao People’s Dem.	Rwanda	Vanuatu

Cote d'Ivoire	Rep	Samoa	Venezuela
Croatia	Latvia	Sao Tome &	Vietnam
Cuba	Lebanon	Principe	West Bank and
Cyprus	Lesotho	Saudi Arabia	Gaza
Czech Republic	Liberia	Senegal	Yemen Arab
Denmark	Libya	Serbia, Republic	Rep
Djibouti	Lithuania	of	Zambia
Dominica	Luxembourg	Seychelles	Zimbabwe

6.4 Empirical Results

This section reports the results of the study. For this study, I use two estimation techniques – pooled OLS estimation and panel data fixed-effects method to examine the impact of variables pertaining to three important dimensions of Eclectic Paradigm.

In table 21, I present a simple OLS panel regression for one hundred and ninety-six countries from 1970–2009 for 39 years using the net inflows of foreign direct investment percentage of GDP as the dependent variable. In Table 22, fixed-effect panel data model is used for the analysis of the same dataset. F-test is used to compute the significance of particular pillars of OLI.

Table 21 Pooled OLS estimation results

		Pooled OLS Regression number				
Eclectic sub-paradigm	Variables	(1)	(2)	(3)	(4)	(5)
	Constant	1.7751*** (0.2743)	-1.7121 (1.0582)	1.8846*** (0.1044)	-1.9426*** (0.6834)	-2.9822*** (1.0935)
Location	*GDP_Growth*		0.0734*** (0.0244)		0.0484** (0.0202)	0.0703*** (0.0257)
	Openness		0.0370*** (0.0020)		0.0255*** (0.0017)	0.0353*** (0.0020)
	Gov_consumption		-0.0481*** (0.0159)		-0.0578*** (0.0152)	-0.0382** (0.0166)
	Capital_formation		-0.0313* (0.0171)		0.1011*** (0.0140)	-0.0083 (0.0176)
	Resource_imports		-0.1801*** (0.0523)		-0.3048*** (0.0488)	-0.1194** (0.0535)
	Domestic_credit		0.0099*** (0.0022)		0.0070*** (0.0021)	0.0026 (0.0023)
	Education		0.01761** (0.0084)		0.0092 (0.0058)	0.0122 (0.0088)
Internalization	*English*	0.8039*** (0.3050)	0.5608* (0.3142)			1.1833*** (.3156)
	French	0.0806 (0.3016)	0.812477** (0.3172)			1.5151*** (0.3326)
	German	-0.5771 (0.3806)	0.1422 (0.3975)			0.3699 (0.3914)
Ownership	*Trademark*			1.8846*** (0.0554)	0.5343*** (0.0554)	1.0586*** (0.0996)
R-squared		0.0164	0.3014	0.0741	0.2193	0.3681
Adjusted R-squared		0.0147	0.2964	0.0738	0.2167	0.3626
F-stat total		9.8619	59.7084	275.7005	83.2512	66.1517
P-value		0.0000	0.0000	0.0000	0.0000	0.0000
F-stat Internalization		9.8619	2.9351			8.8964
P-value		0.0000	0.0324			0.0000
F-stat Location			82.0447		58.9326	68.7353
P-value			0.0000		0.0000	0.0000
F-stat Ownership					93.1328	113.0831
P-value					0.0000	0.0000
No. of observations		1778	1395	3449	2380	1261

This table presents results of pooled OLS regression relating Foreign Direct Investment (FDI) net inflows as a percentage of Gross Domestic Product (GDP) to determinants of Eclectic paradigm. The dependent variable is FDI net inflows as a percentage of Gross Domestic Product (GDP), defined as net inflows (investment inflows minus disinvestment) in the countries from foreign investors, divided by country GDP. Standard errors are given in parenthesis. ***, **, * denote statistical significance at 1%, 5% and 10%, respectively.

Table 22 Panel fixed effect estimation results

		Panel fixed effect estimation number			
Eclectic sub-paradigm	Variables	(1)	(2)	(3)	(4)
	Constant	-10.9071*** (0.8679)	-2.0042 (1.5742)	1.9445*** (0.1122)	-6.7292*** (1.0642)
Location	*GDP_Growth*	0.0203 (0.0373)	0.0412 (0.0293)		0.0248 (0.0186)
	Openness	0.1506*** (0.0102)	0.0175** (0.0073)		0.0415*** (0.0046)
	Gov_consumption		-0.0913** (0.0418)		-0.0488* (0.0269)
	Capital_formation		0.1484*** (0.0251)		0.1281*** (0.0156)
	Resource_imports		-0.4495*** (0.1285)		-0.0999 (0.0784)
	Domestic_credit	0.0612*** (0.0099)	0.0280*** (0.0055)		0.0218*** (0.0032)
	Education		0.0199 (0.0121)		0.0218** (0.0086)
Ownership	*Trademark*			0.8614*** (0.0815)	0.7157*** (0.0736)
R-squared		0.4688	0.8915	0.3520	0.4819
Adjusted R-squared		0.4487	0.8856	0.3198	0.4500
F-stat total		23.2647	150.2622	10.9469	15.1049
P-value		0.0000	0.0000	0.0000	0.0000
F-stat Location		103.5099	16.0747		42.2353
P-value		0.0000	0.0000		0.0000
F-stat Ownership				111.7385	94.5495
P-value				0.0000	0.0000
No. of observations		4926	3260	3449	2380

Note: This table presents results of fixed effect panel estimations. The dependent variable is FDI net inflows as a percentage of Gross Domestic Product (GDP), defined as net inflows (investment inflows minus disinvestment) in the countries from foreign investors, divided by country GDP. Standard errors are given in parenthesis. ***, **, * denote statistical significance at 1%, 5% and 10%, respectively.

6.4.1 Ownership

The variable of *trademark* is highly significant in all regressions at 1%. The results indicate that FDI seems to be the best choice for firms owning internationally famous brands to internalize the foreign operations rather than licencing. Because due to their popular logo or brand name, it is less complicated for them to enter and acquire a good share in the host market.

For ownership, F-stat results show that the variable used in the study is highly significant and has a very good predictive power for FDI inflows. R-squared results show that trademarks explain around 07.41% (pooled OLS estimates) of variation in FDI inflows.

While not reported, I have attempted to analyse the variable measuring the number of patents granted, but it was not a consistent predictor. Further, I could not find the relationship robust, as the coefficient on patents change signs in different regressions.

6.4.2 Location

The potential growth in market size is significant at 1% level in both regression 2 and 5 and at 5% level in regression 4 in Table 21, showing the highly significant relationship with FDI inflows. The good rate of economic growth importantly influences the development and growth of local market,

which lures (horizontal) foreign investments into an economy and indicates good growth prospects (Jensen 2003; Addison and Heshmati 2003; Abbott et al. 2012). On the other hand, the results for *GDP_Growth* do not show significant impact in panel data estimation. While the relationship in the panel models still remains positive, the statistical significance is lost.

Openness to trade is always statistically highly significant in all the regressions both in pooled OLS estimation and fixed effect estimations, showing that liberalization of trade has the greatest influence on FDI inflows (be they trade oriented or not). The governments have long tried to relax economic policies to increase trade. One can clearly see from the results that the trade is complementing rather than being a substitute. This study validates the results of earlier empirical studies showing the highly positive impact of trade liberalization on FDI inflows (Addison and Heshmati 2003; Keller et al. 2007; Asiedu 2002).

Gov_Consumption is usually found with the expected negative sign and has important effects on FDI inflows. These regression results correspond well with the results in the previous chapter on political risk. This shows the negative impact of governments' current expenditure for purchase of goods and services (which also includes expenditure on national defence and security) on foreign investments.

Capital_formation has a unique relationship with FDI inflows. A good ratio of *Capital_formation* shows governments' approach towards building and improving facilities, which also become the reason to attract FDI

inflows. Results in Table 22 containing fixed effects panel results show that the coefficients of gross capital formation are found positive, as predicted, and highly significant. The pooled OLS regression results are highly significant in the anticipated direction in the regression excluding legal tradition, but capital formation loses much of its predictive power when legal origin dummies are added.

Education exerts a positive influence on FDI inflows. The more developed the human capital, the more FDIs is attracted into the country. The variable of *Education* was expected to have positive relationship with FDI inflows as it measures the level of skills possessed by the workforce (Jensen 2003). This variable is found with expected sign and is significant at 5 percent when tested with legal origin variables. Keller et al. (2007) found primary school education to be a significant factor for East Asian countries.

The coefficient of *Resource_imports* shows that FDI inflows are significantly negatively affected by the imports of resources. The lack of industrial resources in the host country acts as a deterrent for investors. Shortage of resources adds additional pressure on businesses operating within a country. Therefore, it seems highly unlikely that firms prefer those locations where industrial inputs are not easily accessible.

Domestic credit to private sector represents the availability of financial capital in the country. The coefficients on *Domestic_credit* variable are highly significant in almost all regressions using pooled OLS and panel estimation. These results suggest that the ease of access to financial resources

assures credit facilities for international investors, which results in attracting more foreign direct investments into an economy. However, the coefficient in 5th regression is insignificant, even though with expected positive direction. This might be due to the short-term nature of financial resources, as these credit instruments are usually available with three to six months maturity.

F-stat performed for location-specific variable show that the variables used in the study are highly significant for the analysis of FDI inflows. R-squared results of pooled OLS estimates with location specific variables show that model explains around 30.14%, 21.93% and 36.81% variation in FDI inflows. On the other hand, panel fixed effects estimation results cover more variation of dependent variable, possibly due to the inclusion of country dummies.

6.4.3 Internalization

Among the legal systems, the dummy variable of *English* legal origin is statistically significant in all regressions. The results support the theory that common legal origin is more investor friendly when compared to all legal systems. On the other hand, the results show that *German* legal system is not very supportive of FDI inflows and in two regressions show negative relationship with FDI inflows. The coefficient of binary variable of *French* legal origin is 1.52 in the fifth regression significant at 1% level. But in other regressions this variable is less significant. The binary variable of *Scandinavian* is used as benchmark.

The results of F-stat and R-squared performed for internalization give an idea that legal origin dummy variables are significant but they do not explain much variation of the dependent variable. This might be due to the fact that there are many possible variables, which also play an important role in terms of FDI inflows. Legal origin is just among one of the many factors that foreign investors may consider.

6.5 Conclusions

In this study, I investigated the impact of different variables pertaining to the three classifications of OLI paradigm on FDI inflows using an annual panel dataset of 196 countries for the period of 1970-2009. This chapter finds that the variable of trademark, signifying the ownership aspects of investing firms, seems to highly affect FDI inflows. The examination of ownership variable show trademark or branding, which in itself is valuable, gives MNEs an advantage over other businesses (whether local or international) and significantly promotes sales and saves costs.

Among location-specific factors, the variable of openness to international trade significantly encourages trade oriented FDI inflows in the country as predicted by earlier empirical literature. The variables of government consumption and gross capital formation both have important implications on FDI inflows. Further, education of the local population has an important influence on direct investments. Similarly, the availability of

industrial resources and access to domestic credit resources play a key role in the investment location decisions of multinational corporations.

In terms of internalization, countries with English and French legal systems are found significantly affecting inward investments, pointing to the confidence of investors in these systems due to the better quality of intellectual property rights, law enforcement and legal protection of investment rights.

The contribution of this chapter, however, is highlighting the importance of the legal origin of countries in attracting FDI inflows. This chapter also emphasizes the significance of each sub-paradigm individually. It also could provide insights into aspects that are important to international investors and guide governments in formulating policies that are friendly to FDI.

The evaluation of the determinants of FDI inflows suggests that if governments want to attract FDI, they need to avoid excessive government spending, as prodigal public expenditure discourage FDI inflows. In order to attract more FDI, governments should invest in the education of the labour force to make human capital more valuable, in the development of infrastructure facilities and set up a legal environment that is conducive to attracting international investors.

Chapter 7
Conclusions

This chapter provides a brief summary of the results derived from the empirical analysis developed throughout this thesis. Policy implications of the study for both investors and governments are discussed. Finally, some suggestions for future work are made on the basis of the study.

7.1 Summary of the Findings

The first empirical chapter has investigated how currency unions and trade agreements affect inward, outward and net (inward-outward) FDI flows. The study was conducted with pooled OLS estimation methods for the period of 1970-2007 using a sample of 180 countries. The evidence from this study suggests that the membership of WTO, which is generally directed to benefit international trade among member countries, is also very beneficial and positively affects all the kinds of FDI i.e. inflows, outflows and net FDI of member countries. This implies that members of WTO are not only gaining in terms of trade but also in terms of their FDI. The regression results imply that membership of EU has no significant impact on the FDI inflows, however, it seems to considerably increase FDI outflows from the members. On the whole, EU membership seems to encourage domestic investors for OFDI. This may be due to the fact that EU has Free Trade Agreements (FTAs) with

a large number of countries and is also currently negotiating FTAs with other countries and regional organisations (European Commission 2012).

The membership of CACM is found insignificant and has a negative relationship with the FDI of its members. Joining CAN significantly increases FDI inflows of its member countries most probably due to what is referred to in the literature as the 'spaghetti bowl effect' (Daniels et al. 2009). This situation binds and strengthens the achievement of common goals in the region. Further, the liberalization of FDI regulations regarding repatriation of earnings and freedom to invest in any sector makes this region more attractive to investors (Bonnett 2004). Another reason may be that most of the members are rich in natural resources and have mainly primary industry.

The membership of CARICOM has noteworthy negative influence on the FDI inflows and outflows, which on the whole has insignificant positive effects on net FDI. These results may be the outcome of the lack of merger and acquisition opportunities due to the underdevelopment and inadequacy of local firms. The results also coincide well with the increased intra-regional trade, which substitute for FDI especially among member countries. No significant difference was observed for the coefficients of Mercosur dummy in the FDI inflows (positive) and outflows (negative) equations. However, membership of Mercosur has important positive relationship with net FDI. Among the ten RTAs, I did not find any significant relationship of the membership of EAC, EAEC, GCC and SACU on FDI.

The most remarkable result to emerge from the data is that the membership in EUROZONE results in around 20 percent of GDP increase in FDI inflows and 23 percent of GDP increase in FDI outflows. These results suggest that joining EUROZONE improves the image of the country for international businesses mostly due to fixed value of currency, relatively stable monetary policy and economic conditions. Further, increase in FDI inflows may enhance competition, saturate domestic market and which motivates domestic businesses to invest in competitors' markets in retaliation.

Among the currency unions, CEMAC has a robust positive effect on inflows and net FDI. The rationale for this phenomenon is that CEMAC countries are rich in oil resources and by looking at their higher exports and stable economic growth compared to WAEMU, it becomes obvious that most of the FDI inflows are channelled towards oil production. On the other hand, strict policy regulations for investments seem to affect the growth of domestic investments. Joining ECCA appears to decrease FDI outflows, as their outward FDIs are concentrated around the same region and if a neighbour country joins the currency union, it is the trade that might get a boost. Dollarization and WAEMU membership appear to have no significant effects on FDIs of member countries. Among the control variables, GDP growth, openness, real interest rate, current account and real GDP per worker have robust effects on the FDIs (inflows, outflows and net FDI). On the other hand, the variable of inflation did not appear to have a major impact on FDIs.

The second empirical chapter analysed the influence of political risk and developments on FDI inflows in a sample of OECD countries. Instead of examining the most discussed relationship between democracy and FDI, this chapter explored more subtle political aspects. Exceptionally outsized government consumption was found to be a deterrent for FDI inflows, especially if they are used for financing the military. The study found no significant difference in the investment attitude of foreign investor regarding left or right wing parties in power. However, investors seem to have less confidence and shy away from investing in countries having centrist governments, most probably due to their lack of commitment to a clear political direction. The same appears to be the case with the impact of parliamentary (coalition) form of government, as this also does not give clear picture of who is involved in decision making and what their priorities are. Instead, investors seemed to have more trust in presidential system. While the study found that FDI inflows are not much affected by the timing of national elections, the lack of political competition was found to negatively influence investors' preferences. The age of main political parties had robust relationship with FDI, as it lowers political uncertainty through enabling investors to access more information about the political spectrum. Furthermore, investors preferred to invest in countries where party of the executive controls all houses with law-making powers, as this reduces the obstacles and delays in decision making and speeds up the implementation of policies.

The last empirical chapter examined the effects of ownership, location and internalization sub-paradigms of Eclectic Theory by analysing different variables. These findings add to a growing body of literature on Eclectic paradigm and further our understanding of it. The evidence from this study suggests that ownership aspects (such as trademark) play an important role in the process of choosing FDI as a method to go international. Trademark or brand save costs, time to establish a successful business in a new country and increase sales of international businesses through brand perception and loyalty.

Among location-specific variables, openness to trade significantly encourages trade oriented FDI inflows in the country as predicted by earlier empirical literature. Increase in government consumption discourages FDI (long term international investments), as it has implications for future taxation levels. On the other hand, gross capital formation motivates international investors, as increased on fixed assets have indirect effects on economy. International investors are also inclined to invest more in countries where labour force is well educated. Skilled labour force has the potential to learn quickly and adopt the new technology used by MNEs. Furthermore, access to domestic credit resources (even short-term) significantly affects the location-specific decisions of investors. If a country is importing more natural resources suggesting lack of availability of important inputs, the MNEs will be disinclined to pursue FDI. This is perhaps unsurprising, as

inability to obtain factors of production quickly leads to higher costs and reduces the efficiency of international business.

For the third sub-paradigm of Eclectic paradigm, study found that investors have more confidence in making long-term investments in countries with English and French legal origin most likely due to the better quality of intellectual property rights, law enforcement and legal protection of investment rights.

7.2 Policy Implications

The country level results derived from my investigation provide rich information for both governments and investors. The present findings suggest several courses of action in order to encourage FDI flows.

7.2.1 Investors

The findings of my research have considerable managerial implications. In order to avoid political uncertainty, MNEs should try to obtain more knowledge about political environment, political parties and the forms of policies they support. It is important to analyse if the host country is self-sufficient in terms of the industrial resources available and whether there are no strict regulations regarding borrowing financial resources. Also the geopolitical situation of a nation is of great interest, as military conflicts can destroy the value of an investment with a great speed. Finally, investors

should be mindful of the legal environment to make sure that their investments are well protected.

7.2.2 Governments

The evaluation of the three important hypotheses, which analysed determinants of FDI, suggests some important implications to be considered to encourage FDI inflows.

The policy makers should avoid unnecessary government spending, especially defence funding which scares away long term investments. Governments should prefer to increase investments towards the development of fixed assets to improve infrastructure facilities, and in education sector to have skilled human capital and the resultant increase in worker productivity. Further, the central banks should try to control important instruments of monetary policy such as real interest rates, as an increase in these rates discourages FDI. The variable of openness is highly significant in all empirical chapters indicating the importance of trade liberalization. Therefore, it is suggested that trade barriers should be minimized to the lowest possible level to get maximum benefits of both trade and FDI. Governments should make important policies for improving GDP growth rate, as it has an impact on FDI.

Governments should try to make its legal system more investment friendly to the start and operation of businesses by protecting investors rights, introducing good intellectual property laws, contract enforcement

laws, and improving the law enforcement in the country. In order to improve the investors' trust and to eliminate political uncertainty, ruling political parties especially centrists and coalition governments should publicize information about their objectives in their manifesto.

7.3 Limitations and Directions for Future Research

Finally, a number of potential limitations need to be considered. Nevertheless, I believe this work could be the basis for future research on the impact of currency unions, trade agreements, political risk and legal origin on FDI.

First, an important limitation is the unavailability of data for some countries. The study on the effects of currency unions and trade agreements was limited by the unavailability of FDI data for Qatar and United Arab Emirates and the unavailability of the two members of GCC countries may have some role in making the coefficient on GCC dummy insignificant. Similarly, Palau, Marshall Islands and Federal States of Micronesia were not included in the sample of dollar using countries and the same is the case with ECCU members of Anguilla and Montserrat. Therefore, future research can be carried with the availability of FDI data for these countries.

The present study has investigated the impact of legal origin of the countries in the context of FDI inflows. Therefore, more detailed variables may be analysed to strengthen the findings regarding legal systems. While

trying to collect a larger set of variables related to legal environment, I have encountered problems with data availability. Perhaps useful indicators of sufficient length will be available in the future, which will help with the task of conducting a more detailed analysis.

Bibliography

Abbott, A., Cushman, D.O. and De Vita, G., 2012. Exchange Rate Regimes and Foreign Direct Investment Flows to Developing Countries. *Review of International Economics,* 20 (1), pp. 95–107.

Addison, T. and Heshmati, A., 2003. The New Global Determinants of FDI Flows to Developing Countries: The Importance of ICT and Democratization. *WIDER Discussion Papers,* 45, pp. 1-29.

Agarwal, J.P., 1980. Determinants of Foreign Direct Investment: A Survey. *Weltwirtschaftsliches Archiv,* 116, pp. 739-773.

Agenor, P.R., 1994. Credibility and Exchange Rate Management in Developing Countries. *Journal of Development Economics,* 45 (1), pp. 1-16.

Agiomirgianakis, G., Dimitrios, A. and Kalliroi, P., 2004. The Determinants Of Foreign Direct Investment: A Panel Data Study For The OECD Countries. City University-London, Departments of Economics, *Discussion Paper Series* 03/06, pp. 3-25.

Ahlquist, J.S., 2006. Economic Policy, Institutions, and Capital Flows: Portfolio and Direct Investment Flows in Developing Countries. *International Studies Quarterly,* 50 (3), pp. 681-704.

Aitken, B., Harrison, A. and Lipsey, R.E., 1996. Wages and Foreign Ownership: A Comparative Study of Mexico, Venezuela, and The United States. *Journal of International Economics,* 40, pp. 345-371.

Alashban, A.A., Hayes, L.A., Zinkhan, G.M. and Balazs, A.L., 2002. International Brand-Name Standardization/Adaptation: Antecedents and Consequences. *Journal of International Marketing*, 10 (3), pp. 22-48.

Alby, S., 2007. Economic Development Challenge in the CFA Franc Zone. Economic Research - BNP Paribas, *Conjoncture*, pp. 17-25.

Alesina, A. and Barro, R.J., 2002. Currency Unions. *Quarterly Journal of Economics*, 117 (2), pp. 409-436.

Alfaro, L., Chanda, A., Kalemli-Ozcan, S. and Sayek, S., 2004. FDI and Economic Growth: The Role of Local Financial Markets. *Journal of International Economics,* 64, pp. 89 – 112.

Aliber, R.Z., 1970. A Theory of Direct Foreign Investment. *In*: Kindleberger, C.P., ed, *The International Corporation*, Cambridge: MIT Press, 17-34

Aliber, R.Z., 1971. The Multinational Enterprise in a Multiple Currency World. *In:* Dunning, J.H., ed., *The Multinational Enterprise*, London: Allen and Unwin, 49-56

Allard, G., 2012. Chinese OFDI in Africa: Trends, Prospects and Threats. *In*: Alon, I., Fetscherin, M. and Gugler, P., ed., *Chinese International Investments,* Hampshire: Palgrave Macmillan,

Alon, T., Hale, G. and Santos, J., 2010. What is China's Capital Seeking in a Global Environment? *FRBSF Economic Letter,* 2010-09, pp. 1-5.

Argimon, I., Gonzalez-Paramo, J.M. and Roldan, J.M., 1997. Evidence of Public Spending Crowing-Out from a Panel of OECD Countries. *Applied Economics,* 29 (8), pp. 1001-1010.

Aristotelous, K., 2005. Do Currency Unions Affect Foreign Direct Investment? Evidence from US FDI Flows into the European Union. *Economic Issues - Stoke on Trent,* 10 (2), pp. 1-30.

Asiedu, E. and Esfahani, H.S., 2001. Ownership Structure in Foreign Direct Investment Projects. *Review of Economics and Statistics,* 83, pp. 647–662.

Asiedu, E. and Lien, D., 2011. Democracy, Foreign Direct Investment and Natural Resources. *Journal of International Economics,* 84, pp. 99–111.

Asiedu, E., 2002. On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different? *World Development,* 30 (1), pp. 107-119.

Asiedu, E., 2006. Foreign Direct Investment in Africa: The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability. *World Economy,* 29 (1), pp. 63–77.

Baer, W., Cavalcanti, T. and Silva, P., 2002. Economic Integration Without Policy Coordination: The Case of Mercosur. *Emerging Markets Review,* 3, pp. 269–291.

Balasubramanyam, V.N., Sapsford, D. and Griffiths, D., 2002. Regional Integration Agreements and Foreign Direct Investment: Theory and Preliminary Evidence. *The Manchester School,* 70 (3), pp. 460–482.

Banga, R., 2003. Impact of Government Policies and Investment Agreements on FDI Inflows. *ICRIER,* 116, pp. 1-43.

Banga, R., 2007. Drivers of Outward Foreign Direct Investment from Asian Developing Economies. *In:* UNESCAP. *Towards Coherent Policy Frameworks: Understanding Trade and Investment Linkages.* Thailand: United Nations Publications, 195-215

Barro, R.J., 1990. Government Spending in a Simple Model of Endogenous Growth. *Journal of Political Economy*, 98 (5), pp.103-126.

Bayoumi, T, and Eichengreen, B., 1994. One Money or Many? Analyzing the Prospects for Monetary Unification in Various Parts of the World. *Princeton Studies in International Finance*, 76, Princeton.

Beck, T., Clarke, G., Groff, A., Keefer, P. and Walsh, P., 2001. New Tools in Comparative Political Economy: The Database of Political Institutions. *World Bank Economic Review*, 15 (1), pp. 165-176.

Becker, J., Fuest, C. And Riedel, N., 2010. Corporate Tax Effects on the Quality and Quantity of FDI. *Oxford University Centre for Business Taxation, WP* 10/13, pp. 1-35.

Behrman, J.N., 1972. *The Role of International Companies in Latin America: Autos and Petrochemicals.* Lexington, MA: Lexington Books.

Bénassy-Quéré, A., Fontagné, A. and Lahrèche-Révil, A., 2001. Exchange-rate Strategies in the Competition for Attracting Foreign Direct Investment. *Journal of the Japanese and International Economies*, 15, pp. 178-198.

Benassy-Quere, A., Fontagne, L. and Lahreche-Revil, A., 2005. How Does FDI React to Corporate Taxation? *International Tax and Public Finance*, 12, pp. 583–603.

Bengoa, M. and Sanchez-Robles, B., 2003. Foreign Direct Investment, Economic Freedom and Growth: New Evidence from Latin America. *European Journal of Political Economy*, 19 (3), pp. 529-545.

Bergsten, C.F., 2010. I Was a Euro Enthusiast. *Economic Journal Watch*, 7 (1), pp 53-55.

Besley, T., Persson, T. and Sturm, D.M., 2010. Political Competition, Policy and Growth: Theory and Evidence from the US. *Review of Economic Studies,* 77 (4), pp. 1329-1352.

Bialkowski, J., Gottschalk, K. and Wisniewski, T.P., 2008. Stock Market Volatility round National Elections. *Journal of Banking and Finance,* 32 (9), pp. 1941-1953.

Blanchard, P., Gaigné , C. And Mathieu, C., 2007. Foreign Direct Investment. The Lessons from Panel Data. *Institute National de la recherche Agronomique,* 07-05, pp. 1-40.

Blejer, M.I. and Khan, M.S., 1984. Government Policy and Private Investment in Developing Countries. *Staff Papers - International Monetary Fund,* 31 (2), pp. 379-403.

Blomstrom, M. and Kokko, A., 1997. Regional Integration and Foreign Direct Investment. *NBER Working paper,* 172, pp. 1-30.

Blonigen, B.A., 1997. Firm-Specific Assets and the Link between Exchange Rates and Foreign Direct Investment. *The American Economic Review,* 87 (3), pp. 447-465.

Blonigen, B.A., 2005. A Review of the Empirical Literature on FDI Determinants. *Atlantic Economic Journal,* 33, pp. 383–403.

Blonigen, B.A., Davies, R.B., Waddell, G.R. and Naughton, H.T., 2007. FDI in Space: Spatial Autoregressive Relationships in Foreign Direct Investment. *European Economic Review*, 51, pp. 1303–1325.

Blonigen, B.A. and Piger, J., 2011. Determinants of Foreign Direct Investment. *NBER Working Paper Series,* 16704, pp. 1-47.

Bonnett, E.T., 2004. Foreign Direct Investment and The Investment Climate of Developing Countries in the Western Hemisphere. PhD Thesis, Available: http://etd.fcla.edu/UF/UFE0008325/bonnett_e.pdf [Accessed April 20, 2011].

Booth, J.R. and Booth, L.C., 2003. Is Presidential Cycle in Security Returns Merely a Reflection of Business Conditions? *Review of Financial Economics*, 12 (2), pp. 131-159.

Boubakri, N., Cosset, J.C., Debab, N. And Valéry, P., 2009. The Dynamics of Foreign Direct Investment and Privatization: An Empirical Analysis. *International Management*, 13 (2), pp. 81-92.

Boughton, J.M., 1991. The CFA Franc Zone: Currency Union and Monetary Standard. *IMF Working Paper Series*, WP/91/133, pp. 1-31.

Brenton, P., Di Mauro, F. and Lucke, M., 1999. Economic Integration and FDI: An Empirical Analysis of Foreign Investment in the EU and in Central and Eastern Europe. *Empirica,* 26 (2), pp. 95-121.

Breusch, T.S. and Pagan, A.R., 1979. A Simple Test for Heteroskedasticity and Random Coefficient Variation. *Econometrica*, 48 (5), pp. 1287-1294.

Brouwer, J., Paap, R. and Viaene, J.M., 2008. The Trade and FDI Effects of EMU Enlargement. *Journal of International Money and Finance,* 27 (2), pp. 188-208.

Buch, C.M. and Piazolo, D., 2001. Capital and Trade Flows in Europe and the Impact of Enlargement. *Economic Systems,* 25, pp. 183-214.

Buckley, P.J. and Casson, M.C., 1976. *The Future of Multinational Enterprise,* Macmillan and Co: London.

Buckley, P.J. and Casson, M.C., 2009. The Internalisation Theory of the Multinational Enterprise: A Review of The Progress of a Research Agenda After 30 Years. *Journal of International Business Studies,* 40, pp. 1563–1580.

Buckley, P.J. and Castro, F.B., 1998. The Investment Development Path: the Case of Portugal. *Transnational Corporations, 7* (1), pp.1-15.

Buckley, P.J., Clegg, L.J., Cross, A.R., Liu, X., Voss, H. and Zheng, P., 2007. The Determinants of Chinese Outward Foreign Direct Investment. *Journal of Business Studies,* 38, pp. 499-518.

Bun, M.J.G. and Klaassen, F.J.G.M., 2007. The Euro Effect on Trade is not as Large as Commonly Thought. *Oxford Bulletin of Economics and Statistics,* 69 (4), pp. 473-496.

Bun, M.J.G. and Windmeijer, F., 2007. The Weak Instrument Problem of The System GMM Estimator In Dynamic Panel Data Models. *Amsterdam School of Economics Discussion Paper* 2007/01, pp. 1-48.

Busse, M. and Groizard, J.L., 2008. Foreign Direct Investment, Regulations and Growth. *The World Economy,* 31 (7), pp. 861-886.

Busse, M. and Hefeker, C., 2007. Political risk, Institutions and Foreign Direct Investment. *European Journal of Political Economy,* 23, pp. 397–415.

Busse, M., Hefeker, C. and Nelgen, S., 2010. Foreign Direct Investment and Exchange Rate Regimes. *MAGKS Papers on Economics,* 15, pp. 1-28.

Cantwell, J., 2000. A Survey of Theories of International Production. *In:* Pitelis, C.N. and Sugden, R., 2nd ed. *The Nature of the Transnational Firm, London: Routledge, 10-56*

Cargill, T.F. and Hutchison, M.M., 1991. Political Business Cycles with Endogenous Election Timing: Evidence from Japan. *Review of Economic and Statistics,* 73 (4), pp. 733-739.

Caribbean Community Secretariat, 2009. *The Caribbean CommunitySecretariat.* Available from: http://www.caricom.org/jsp/secretariat/secretariat_index.jsp?menu=secretariat.

Carkovic, M. and Levine, R., 2005. Does Foreign Direct Investment Accelerate Economic Growth? *In:* Moran, T., Graham, E. and Blomstrom, M., eds., *Does Foreign Direct Investment Promote Development?* Institute for International Economics and Center for Global Development, Washington, DC, pp. 195–220

Celli, U., Tussie, D., Peixoto, J. and Salles, M., 2011. Mercosur as an Incipient Model of Regional Integration Based on South-South Trade Cooperation. Mimeo.

Cernat, L., 2002. Assessing Regional Trade Arrangements: Are South-South RTAs more Trade Diverting? *Policy Issues in International Trade and Commodities Study*, 16, pp. 1-24.

Chai, J. and Goyal, R., 2008. Tax Concessions and Foreign Direct Investment in the Eastern Caribbean Currency Union. *IMF Working Paper,* WP/08/257, pp. 1-33.

Chakrabarti, A., 2001. The Determinants of Foreign Direct Investment: Sensitivity Analysis of Cross-Country Regressions. *Kyklos,* 54 (1), pp. 89-114.

Chamberlain, G., 1978. Omitted Variable Bias in Panel Data: Estimating the Returns to Schooling. *Annales de L'Insee,* 30-31, pp. 49-82.

Choi, I., 2001. Unit Root Tests for Panel Data. *Journal of International Money and Finance,* 20 (2), pp. 249-272.

Choi, S.W. and Samy, Y., 2008. Reexamining the Effects of Democratic Institutions on Inflows of Foreign Direct Investment in Developing Countries. *Foreign Policy Analysis,* 4 (1), pp. 83-103.

Chowdhury, A. and Mavrotas, G., 2006. FDI and Growth: What Causes What? *The World Economy,* 29 (1), pp. 9-19.

Coase, R.H., 1937. The Nature of the Firms. *Economica,* 4 (16), pp. 386-405.

Cubeddu, L., Bauer, A., Berkmen, P., Kandil, M., Nassar, K., and Mullins, P., 2008. Tax Incentives and Foreign Direct Investment: Policy Implications for the Caribbean. *In:* Bauer, A., Cashin, P. and Panth, S., ed. *The Caribbean - Enhancing Economic Integration*. International Monetary Fund: Washington, DC, 44-81.

da Silva Lopes, T., 2010. The Entrepreneur, Ownership Advantages and the Eclectic Paradigm. *Multinational Business Review,* 18 (2), pp.71-88.

Daniel, A., 2010. Foreign Direct Investment in East Africa. A Comparative Analysis of its Investment Laws. Mimeo.

Daniels, J.D., Radebaugh, L.H. and Sullivan, D.P., 2004. *International Business: Environments and Operations.* 10 ed., Pearson Prentice Hall: New Jersey.

Daniels, J.D., Radebaugh, L.H. and Sullivan, D.P., 2009. *International Business - Environments and Operations.* 12th ed. London: Pearson Education,

Dawar, N. and Parker, P., 1994. Marketing Universals: Consumers' Use of Brand Name, Price, Physical Appearance, and Retailer Reputation as Signals of Product Quality. *Journal of Marketing*, 58 (2), pp. 81-95.

de Chernatony, L. and McWilliam, G., 1989. The Varying Nature Of Brands As Assets: Theory And Practice Compared. *School Working Paper,* SWP38/89, pp. 1-18.

De Sousa, J. and Lochard, J., 2006. Does the Single Currency Affect Foreign Direct Investment? A Gravity Like Approach. Mimeo.

Dedman, M.J., 2010. *The Origins and Development of the European Union 1945–2008 - A History of European Integration*. 2nd ed. Oxon: Routledge.

Dhakal, D., Mixon, J. F. and Upadhyaya, K., 2007. Foreign Direct Investment and Transition Economies: Empirical Evidence from a Panel Data Estimator. *Economics Bulletin*, 6 (33), pp. 1-9.

Duffy, J., Nikitin, M. and Smith, R.T., 2006. Dollarization Traps. *Journal of Money, Credit, and Banking*, 38 (8), pp. 2073-2097.

Dunning, J.H. and Dilyard, J.R., 1999. Towards a General Paradigm of Foreign Direct and Foreign Portfolio Investment. *Transnational Corporations,* 8 (1), pp. 1-52.

Dunning, J.H. and Lundan, S.M., 2008. *Multinational Enterprises and the Global Economy*. 2nd Edition, Northampton, MA: Edward Elgar Publishing.

Dunning, J.H. and Rugman, A.M., 1985. The Influence of Hymer's Dissertation on the Theory of Foreign Direct Investment. *American Economic Review,* 75 (2), pp. 228-232.

Dunning, J. H., 1958. American Investment in British Manufacturing Industry. London: George Allen and Unwin. (New, revised and updated edition, London: Routledge, 1998).

Dunning, J. H. 1977. Trade, Location of Economic Activity and the MNE: A Search for an Eclectic Approach. *In*: Ohlin, B., Hesselborn, P. O. & Wijkman, P. M., *The International Allocation of Economic Activity,* London: Macmillan. pp. 395–418

Dunning, J.H., 1980. Toward an Eclectic Theory of International Production: Some Empirical Tests. *Journal of International Business Studies,* 26 (3), pp. 9-31.

Dunning, J.H., 1981a. Explaining the International Direct Investment Position of Countries: Towards a Dynamic or Developmental Approach. *Review of World Economics,* 117 (1), pp. 30-64.

Dunning, J.H., 1981b. *International Production and the Multinational Enterprise.* London: Allen and Unwin.

Dunning, J.H., 1993. *Multinational Enterprises and the Global Economy.* Wokingham: Addison-Wesley Publishing Company.

Dunning, J.H., 1996. Re-evaluating the Benefits of FDI. *In:* UNCTAD., *Companies Without Borders –Transnational Corporations in the 1990s*. London: International Thomson Press.

Dunning, J.H., 2000a. The Eclectic Paradigm as an Envelope for Economic and Business Theories of MNE Activity. *International Business Review,* 9, pp. 163–190.

Dunning, J.H., 2000b. A Rose By Any Other Name.....? FDI Theory in Retrospect and Prospect. Mimeo, University of Reading and Rutgers University,

Dunning, J.H., 2001. The Eclectic (OLI) Paradigm of International Production: Past, Present and Future. *International Journal of the Economics of Business,* 8 (2), pp. 173-190.

Dwane, C., Lane, P.R. and MCindoe, T., 2010. Currency Unions and Irish External Trade. *Applied Economics,* 42 (19), pp. 2393-2397.

East African Community, 2012. East African Community – One People One Destiny. Available from: http://www.eac.int/index.php?option=com_content&view=article&id=1:welcome-to-eac&catid=34:body-text-area&Itemid=53 [Accessed May 20, 2012].

Eckel, C., 2001. Fragmentation, Efficiency-Seeking FDI and Employment. *Review of International Economics,* 11 (2), pp. 317–331.

Edwards, S. and Magendzo, I.I., 2003. A Currency of One's Own? An Empirical Investigation on Dollarization and Independent Currency Unions. *National Bureau of Economic Research Working Paper*, 9514, pp. 1-41.

Edwards, S., 1990. Capital Flows, Foreign Direct Investment, and Debt-Equity Swaps in Developing Countries. *NBER Working Paper,* 3497, pp. 1-35.

Eiteman, D.K., Stonehill, A.I. and Moffett, M.H., 2010. *Multinational Business Finance.* 12th ed., Pearson Prentice Hall: Boston.

Elbadawi, I. A. and Mwega, F.M., 1998. Regional Integration, Trade and Foreign Direct Investment in Sub-Saharan Africa. *In:* Iqbal, Z. and Khan, M.S., ed. *Trade Reform and Regional Integration in Africa*. International Monetary Fund: Washington D.C., 369-394

Europa, 2011. Basic Information on European Union. Available from: http://europa.eu/about-eu/basic-information/index_en.htm.

European Central Bank, 2010. European Central Bank. Available from: http://www.ecb.europa.eu/euro/intro/html/map.en.html [Accessed March 02, 2010].

European Commission, 2012. International Affairs – Free Trade Agreements. Available from: http://ec.europa.eu/enterprise/policies/international/facilitating-trade/free-trade/index_en.htm#h2-2 [Accessed September 22, 2012].

Eurostat, 2008. *European Union Foreign Direct Investment Yearbook 2008. Data 2001-2006.* Luxembourg: European Commission,

Fabris, N., 2009. Implications of Dollarization with a Special Overview of Montenegro. *Transformations monétaires et financières dans les pays d'Europe centrale et orientale,* 11, pp. 3-30.

Faria, A. and Mauro, P., 2004. Institutions and the External Capital Structure of Countries. *IMF Working Paper,* WP/04/236, pp. 1-30.

Farrell, R., Gaston, N. and Sturm, J.E., 2004. Determinants of Japan's Foreign Direct Investment: an Industry and Country Panel Study 1984-1998. *Journal of the Japanese and International Economies,* 18, pp. 161-182.

Fielding, D. and Shields, K., 2003, Economic Integration in West Africa: Does the CFA Make a Difference? Department of Economics, *University of Leicester Discussion Paper,* 001, pp. 1-24. Available from: https://lra.le.ac.uk/handle/2381/4417.

Fielding, D. and Shields, K., 2005. Do Currency Unions Deliver More Economic Integration Than Fixed Exchange Rates? Evidence from the Franc Zone and the ECCU. *Journal of Development Studies,* 41, pp. 1051-1070.

Flam, H., 2009. The Impact of the Euro on International Trade and Investment: A Survey of Theoretical and Empirical Evidence. *Swedish Institute for European Policy Studies (SIEPS),* 8, pp. 1-55.

Foad, H., 2006. Export-oriented FDI and the adoption of the Euro. Mimeo.

Flowers, E.B., 1976. Oligopolistic Reactions in European and Canadian Direct Investment in the United States. *Journal of International Business Studies,* 7 (2), pp. 43-55.

Fonseca, M., 2008. The Investment Development Path Hypothesis: A Panel Data Approach to the Portuguese Case. *FEP Working Papers,* 303, pp. 1-24.

Frankel, J. and Rose, A., 2002. An Estimate of the Effect of Common Currencies on Trade and Income. *Quarterly Journal of Economics,* 117 (2), pp. 437-466.

Froot, K.A. and Stein, J.C., 1991. Exchange Rates and Foreign Direct Investment: An Imperfect Capital Markets Approach. *The Quarterly Journal of Economics,* 106 (4), pp. 1191-1217.

Froot, K.A. and Stein, J.C., 1991. Exchange Rates and Foreign Direct Investment: An Imperfect Capital Markets Approach. *The Quarterly Journal of Economics,* 106 (4), pp. 1191-1217.

Gaughan, P.A., 2005. *Merger: What Can Go Wrong and How to Prevent It.* John Wiley & Sons Inc.: New Jersey.

Gertner, R.H., Scharfstein, D.S. and Stein, J.C., 1994. Internal Versus External Capital Markets. *The Quarterly Journal of Economics,* 109 (4), pp. 1211-1230.

Ghose, A.K., 2004. Capital Inflows and Investment in Developing Countries. *Employment Strategy Papers,* 11, pp. 1-46.

Gladwin, T.N. and Giddy, I.H., 1973. A Survey of Foreign Direct Investment Theory. *Division of Research, Graduate School of Business Administration, University of Michigan Working Paper,* 86, pp. 1-46.

Gleason, G., 2003. The Reintegration of Eurasia: Functional Theory and Interstate Policy Coordination Paper Prepared for the Panel The European Union and Post-Communist Space SA22. 44th Annual Convention of the International Studies Association Portland, Oregon Feb. 25 - March 1, 2003

Glick, R. and Rose, A.K., 2002. Does a Currency Union Affect Trade? The Time-Series Evidence. *European Economic Review,* 46 (6), pp. 1125-1151.

Globerman, S. and Shapiro, D., 2002. Global Foreign Direct Investment Flows: The Role of Governance Infrastructure. *World Development,* 30 (11), pp. 1899–1919.

Godfrey, L.G., 1978. Testing for Multiplicative Heteroskedasticity. *Journal of Econometrics,* 8 (2), pp. 227-236.

Goldberg, L.S. and Kolstad, C.D., 1994. Foreign Direct Investment, Exchange Rate Variability and Demand Uncertainty. *NBER Working Paper Series.* 4815. pp. 1-26.

Goldstein, A.E., 2004. *Regional Integration, FDI and Competitiveness in Southern Africa.* Organization for Economic Co-operation and Development: Paris. pp. 19-36

Gorynia, M., Nowak, J. and Wolniak, R., 2010. Investment Development Paths of Central European Countries: A Comparative Analysis. *Argumenta Oeconomica,* 1 (24), pp. 65-87.

Grier, K.B. and Tullock, G., 1989. An Empirical Analysis of Cross-National Economic Growth, 1951-80. *Journal of Monetary Economics,* 24, pp. 259-276.

Grosse, R. and Trevino, L.J., 1996. Foreign Direct Investment in the United States: An Analysis by Country of Origin. *Journal of International Business Studies,* 27 (1), pp. 139-155.

Gujarati, D., 2003. *Basic Econometrics*. 4th Edition, McGraw Hill: Boston.

Gujarati, D. and Porter, D., 2008. *Basic Econometrics.* 5th Edition, McGraw Hill: Boston.

Gulde, A.M., 2008. Overview. *In:* Gulde, A.M. and Tsangarides, C., ed. *The CFA Franc Zone: Common Currency, Uncommon Challenges.* International Monetary Fund: Washington D.C., 1-24

Gurtner, F.J., 1999. The CFA Franc Zones and the Theory of Optimum Currency Area. *Africa Spectrum,* 34 (1), pp. 33-57.

Haddad, M. and Harrison, A., 1993. Are There Positive Spillovers from Direct Foreign Investment? Evidence from Panel Data for Morocco. *Journal of Development Economics,* 42, pp. 51-74.

Hanke, S.H. and Schuler, K., 1999. A Dollarizaton Blueprint for Argentina. *Foreign Policy Briefing,* 52, pp. 1-25.

Haselmann, R. and Herwartz, H., 2010. The Introduction of the Euro and its Effects on Portfolio Decisions. *Journal of International Money and Finance*, 29 (1), pp. 94–110.

Hausman, J. and Taylor, W., 1981. Panel Data and Unobservable Individual Effects. *Econometrica*, 49 (6), pp. 1377-1398.

Hausman, J., 1978. Specification Tests in Econometrics. *Econometrica,* 46 (6), pp. 251-1271.

Hensel, C.R. and Ziemba, W.T., 1995. United States Investment Returns during Democratic and Republican Administrations 1928-1993. *Financial Analysts Journal,* 51 (2), pp. 61-69.

Herbst, A.F. and Slinkman, C.W., 1984. Political-Economic Cycles in the U.S. Stock Market. *Financial Analysts Journal,* 40 (2), pp. 38-44.

Hibbs, D.A. Jr., 1977. Political Parties and Macroeconomic Policy. *American Political Science Review*, 71 (4), pp. 1467-1487.

Holland, D. and Pain, N., 1998. The diffusion of innovations in central and eastern Europe: a study of the determinants and impact of foreign direct investment. *National Institute of Social and Economic Research,* NIESR Discussion Paper No.137, pp. 1-49.

Hsiao, C., 2006. Panel Data Analysis – Advantages and Challenges. *IEPR Working Paper*, 06.49, pp. 1-31.

Hymer, S.H., 1960. *The International Operations of National Firms, A Study of Direct Foreign Investment.* Cambridge, MA: MIT Press,

IDEA, 2011. IDEA Voter Turnout Database. Available from: www.electionguide.org, [Accessed September 12, 2011].

Ietto-Gillies, G., 2007. Theories of International Production: a Critical Perspective. *Critical Perspectives on International Business,* 3 (3), pp. 196-210.

IFES, 2011. Election Guide, Database. Available at: www.electionguide.org, [Accessed September 12, 2011]

IMF Balance of Payment Statistics, 2009. Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual. *International Monetary Fund.*

International relations and cooperation, 2003. Central African Economic and Monetary Community (CAEMC) / Communaute Economique et Monetaire d'Afrique Centrale (CEMAC). Available from: http://www.dfa.gov.za/foreign/Multilateral/africa/caemc.htm [Accessed December 20, 2010]

Jakobsen, J. and de Soysa, I., 2006. Do Foreign Investors Punish Democracy? Theory and Empirics, 1984–2001. *KYKLOS,* 59 (3), pp. 383–410.

Jaumotte, F., 2004. Foreign Direct Investment and Regional Trade Agreements: The Market Size Effect Revisited. *International Monetary Fund,* WP/04/206, pp. 1-31.

Jensen, N.M., 2003. Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment. *International Organization,* 57, pp. 587- 616.

Johnson, R.R., Chittenden, W. and Jensen, G., 1999. Presidential Politics, Stocks, Bonds, Bills, and Inflation: Some New Differences Identified. *The Journal of Portfolio Management,* 26 (1), pp. 27-31.

Julio, B. and Yook, Y., 2012. Political Uncertainty and Corporate Investment Cycles. *The Journal of Finance,* 67 (1), pp. 45-84.

Katembo, B., 2008. Pan Africanism and Development: The East African Community Model. *The Journal of Pan African Studies,* 2 (4), pp. 107-112.

Keller, K., Gilbert, A. and Stankiewicz, A., 2007. An Empirical Analysis of the Determinants of Foreign Direct Investment with a Focus on Asia. *NABET 2007 Proceedings,* pp. 241-254.

Kenen, P.B., 1969. The Theory of Optimum Currency Areas: An Eclectic View. *In*: Mundell, R.A. and Alexander K. Swoboda, A.K., Eds., *Monetary Problems of the International Economy.* Chicago, USA: University of Chicago Press.

Kim, B.Y. and Mah, J.S., 2007. The Macroeconomic Effects of Dollarization: Ecuador and El Salvador. *America as eBay,* 92, pp. 1-18.

Kindleberger, Charles P. 1969. *American Business Abroad: Six Lectures on Direct Investment.* New Haven: Yale University Press.

Kirk, R. and Stern, M., 2005. The New Southern African Customs Union Agreement. *The World Economy*, 28 (2), pp. 169–190.

Knickerbocker, F. T., 1973. Oligopolistic Reaction and Multinational Enterprise. *The International Executive,* 15(2), pp. 7-9.

Kobrin, S.J., 1979. Political Risk: A Review and Reconsideration. *Journal of International Business Studies,* 10 (1), pp. 67-80.

Kojima, K., 1973. A Macroeconomic Approach to Foreign Direct Investment. *Hitotsubashi Journal of Economics,* 14(1), pp. 1-21.

Kojima, K., 1977. Transfer of Technology to Developing Countries – Japanese Type versus American Type. *Hitotsubashi Journal of Economics*, 17(2), pp. 1-14.

Krapohl, S. and Muntschick, J., 2008. Two Logics of Regionalism: The Importance of Interdependence and External Support for Regional Integration

in Southern Africa. FOPRISA 3rd Annual Conference, Centurion/Pretoria, pp. 1-36.

Kubny, J., Mölders, F. and Nunnenkamp, P., 2008. Regional Integration and FDI in Emerging Markets. *Kiel Working Papers*, 1418, pp. 1-36.

Kyrkilis, D. and Pantelidis, P., 2003. Macroeconomic Determinants of Outward Foreign Direct Investment. *International Journal of Social Economics*, 30 (7), pp. 827-836.

La Porta, R., Lopez-de-Silanes, F. and Shleifer, A., 2008. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, 46 (2), pp. 285-332.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., and Vishny, R.W., 1996. Law and Finance. *NBER Working Paper*, 5661, pp. 1-79.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., and Vishny, R.W., 1997. Legal Determinants of External Finance. *Journal of Finance,* 52 (3), pp. 1131–1150.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R.W., 1998. Law and Finance. *Journal of Political Economy,* 106 (6), pp. 1113–1155.

Landau, D., 1983. Government Expenditure and Economic Growth: A Cross-Country Study. *Southern Economic Journal,* 49 (3), pp.783-792.

Lankes, H.P. and Venables, A.J., 1996. Foreign Direct Investment in Economic Transition: The Changing Pattern of Investments. *Economics of Transition*, 4, pp. 331-347.

Laubach, T., 2009. New Evidence on the Interest Rate Effects of Budget Deficits and Debt. *Journal of the European Economic Association,* 4 (4), pp. 858-885.

Levin, A., Lin, C.F. and Chu, C.S.J., 2002. Unit Root Tests in Panel Data: Asymptotic and Finite Sample Properties. *Journal of Econometrics*, 108 (1), pp. 1-24.

Levine, R., 1998. The Legal Environment, Banks, and Long-Run Economic Growth. *Journal of Money, Credit and Banking,* 30 (3), pp. 596-613.

Levy Yeyati, E., Stein, E. and Daude, C., 2003. Regional Integration and the Location of FDI. *Inter-American Development Bank,* Working Paper492, pp. 1-33.

Li, Q. and Resnick, A., 2003. Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries. *International Organization,* 57 (1), pp. 175-211.

Lipsey, R.E., 2000. Interpreting Developed Countries' Foreign Direct Investment. *NBER Working Paper Series,* 7810, pp. 1-44.

Lizondo, J.S., 1990. Foreign Direct Investment. *IMF Working Paper,* WP/90/63, pp. 1-28.

Lundan, S.M., 2010. What are Ownership Advantages? *Multinational Business Review,* 18 (2), pp. 51–70.

Luo, Y., 2009. Political Risk and Country Risk in International Business – Concepts and Measures. *In:* Rugman, A.M., 2nd ed. *The Oxford Handbook of International Business,* New York: Oxford University Press, 740-764

Macasaquit, Meri-Len, R., 2006. Forming a Government: Parliamentary vs. Presidential System. *Philippine Institute for Development Studies*, 6 (2), pp. 1-2.

Mace, G., 1988. Regional Integration in Latin America: A Long and Winding Road. *International Journal,* 43 (3), pp. 404-427.

Maddala, G.S. and Wu, S., 1999. A Comparative Study of Unit Root Tests with Panel Data and a New Simple Test. *Oxford Bulletin of Economics and Statistics,* 61 (S1), pp. 631-652.

Madura, J. and Fox, R., 2007. *International Financial Management.* Thomson Learning: London.. 37-42

Mahadeva, L. and Robinson, P., 2004. Unit Root Testing to Help Model Building. *Handbooks in Central Banking,* 22, pp. 1-51.

Malamud, A., 2004. Regional Integration in Latin America: Comparative Theories and Institutions. *Sociologia. Problemas e Prácticas,* 44, pp. 135-154.

Markusen, J.R., 1983. Factor Movements and Commodity Trade as Complements. *Journal of International Economics,* 14 (3-4), pp. 341-356.

McKinnon, R.I., 1963. Optimum Currency Areas. *The American Economic Review,* 53 (4), pp. 717-725.

McKinnon, R., 2000. The East Asian Dollar Standard, Life after Death? *Economic Notes, Banca Monte dei Paschi di Siena*, 29, pp. 31-82.

Méon, P.-G. and Sekkat, K., 2007. Revisiting the Relationship between Governance and Foreign Direct Investment. *Brussels Economic Review*, 50 (1), pp. 40-60.

Meyer, K., 1998. *Determinants of Direct Investment: A Review of the Literature. Direct Investment in Economies in Transition,* Cheltenham: Elgar, 59-79

Meyer, K.E. and Estrin, S., 1999. Entry Mode Choice in Emerging Markets: Greenfield, Acquisition, and Brownfield. *CEES Working Papers*, 18, pp. 1-29.

Meyer, K.E., Estrin, S., Bhaumik, S.K. and Peng, M.W., 2008. Institutions, Resources, and Entry Strategies in Emerging Economies. *Strategic Management Journal*, 30, pp. 61–80.

Micco, A., Stein, E. and Ordonez, G., 2003. The Currency Union Effect on Trade: Early Evidence from EMU. *Economic Policy,* 18 (37), pp. 315-356.

Milberg, W., 1999. Foreign Direct Investment and Development: Balancing Costs and Benefits. *International Monetary and Financial Issues for the 1990s,* 6, pp. 99-116.

Mina, W., 2007. Are the GCC FDI Location Determinants Favorable? *Economics Discussion Papers*, 23, pp. 1-30.

Moghaddam, A.A. and Redzuan, M., 2012. Globalization and Economic Growth: A Case Study in a Few Developing Countries (1980-2010). *Research in World Economy,* 3 (1), pp. 54-62.

Mohan, P. and Watson, P.K., 2010. CARICOM Cross-Border Equity Flows. *First Caribbean International Bank,* pp. 1-40.

Moosa, I.A., 2002. *Foreign Direct Investment: Theory, Evidence and Practice.* Palgrave: New York, 23-39

Moosa, I.A., 2009. The Determinants of Foreign Direct Investment in MENA Countries: an Extreme Bounds Analysis. *Applied Economics Letters,* 16 (15), pp.1–5.

Motta, M. and Norman, G., 1996. Does Economic Integration Cause Foreign Direct Investment? *International Economic Review,* 37 (4), pp. 757-783.

Mudambi, R. and Navarra, P., 2003. Political Tradition, Political Risk and Foreign Direct Investment in Italy. *Management International Review*, 43 (3), pp. 247-265.

Mundell, R.A., 1957. International Trade and Factor Mobility. *The American Economic Review,* 47 (3), pp. 321-335.

Mundell, R.A., 1961. A Theory Of Optimum Currency Areas. *The American Economic Review,* 51(4), pp. 657-665.

Narula, R. and Guimon, J., 2010. The Investment Development Path in a Globalised World: Implications for Eastern Europe. *Eastern Journal of European Studies,* 1 (2), pp. 5-19.

Ndiaye, A.S., 2010. The Role of Capital Flight in the Fluctuations in Domestic Investment: Evidence from the African Countries in the Franc Zone. Centre for the Study of African Economies, Conference on Economic Development in Africa, 21 - 23 March 2010, St Catherine's College, Oxford, United Kingdom.

Neumayer, E. and Spess, L., 2005. Do Bilateral Investment Treaties increase Foreign Direct Investment to Developing Countries? *World Development*, 33 (10), pp. 1567-1585.

Ng, T.H., 2002. Should The Southeast Asian Countries Form A Currency Union? *The Developing Economies,* 40 (2), pp. 113-134.

Nigh, D., 1985. The Effect of Political Events on United States Direct Foreign Investment: A Pooled Time-Series Cross-Sectional Analysis. *Journal of International Business Studies,* 16 (1), pp. 1-17.

Nitsch, V., 2002. Honey, I Shrunk the Currency Union Effect on Trade. *The World Economy,* 25(4), pp. 457-474.

Noorbakhsh, F., Paloni, A. and Youssef, A., 2001. Human Capital and FDI Inflows to Developing countries: New Empirical Evidence. *World Development,* 29 (9), pp. 1593-1610.

Nordhaus, W.D., 1975. The Political Business Cycle. *Review of Economic Studies,* 42 (2), pp. 169-190.

Nunnenkamp, P., 2001. Foreign Direct Investment in Developing Countries: What Policymakers Should not do and What Economists Don't Know. *Kieler Diskussionsbeiträge,* 380, pp. 1-19. Downloadable at http://www.econstor.eu/handle/10419/2616.

OECD, 2008. OECD Investment News. Available from: http://www.oecd.org/dataoecd/18/28/40887916.pdf, [Accessed February 13, 2012].

OECD, 2008. The New OECD Benchmark Definition of Foreign Direct Investment Enters into Force. *OECD Investment News,* 7, downloadable at: http://www.oecd.org/investment/investmentpolicy/2090148.pdf.

OECD, 2011. *Main Economic Indicators (Edition: October 2011).* ESDS International, University of Manchester.

Oneal, J.R., 1994. The Affinity of Foreign Investors for Authoritarian Regimes. *Political Research Quarterly,* 47 (3), pp. 565-588.

Oshikoya, T.W., 1994. Macroeconomic Determinants of Domestic Private Investment in Africa: An Empirical Analysis. *Economic Development and Cultural Change,* 42 (3), pp. 573-596.

Peeters, M., 2010. The Changing Pattern in International Trade and Capital Flows of the Gulf Cooperation Council Countries in Comparison with other Oil-Exporting Countries. *European Economy Economic Papers,* 415, pp. 1-25.

Petroulas, P., 2007. The Effect of the Euro on Foreign Direct Investment. *European Economic Review,* 51 (6), pp. 1468-1491.

Pinto, P.M. and Pinto, S.M., 2008. The Politics of Investment Partisanship and the Sectoral Allocation of Foreign Direct Investment. *Politics and Economics,* 20 (2), pp. 216-254.

Phillips, P.C.B. and Perron. P., 1988. Testing For A Unit Root In Time Series Regression. *Biometrika*, 75, pp. 335-346.

Pompret, R., 2006. Regional Trade Agreements. *In:* Fratianni, M., ed. *Regional economic integration.* Amsterdam: Elsevier, 39–54.

Pongsiri, N., 2005. Foreign Direct Investment and Regulation: a Case Study of Thailand's Upstream Oil and Gas Industry. *In*: Walde, T. eds. *Oil, Gas & Energy Law Intelligence (OGEL),* 3 (4), 48-60

Puiu, C., 2011. Optimum Currency Area: An Epistemological View. *Munich Personal RePEc Archive*, 35055, pp.1-11.

Ramirez, G. and Tsangarides, C.G., 2007. Competitiveness in the CFA Franc Zone. *IMF Working Papers*, 07/212, pp. 1-40.

Ramirez, M.D., 2010. Economic and Institutional Determinants of FDI Flows to Latin America: A Panel Study. *Trinity College, Department of Economics*, Working Papers 10-03, pp. 1-35.

Rarick, C.A., 2004. The Competitive Advantage of Local Firms in Developing Economies: The Case of Bajaj of India. Available from: http://ssrn.com/abstract=1118544 [Accessed December 10, 2010]

Razafimahefa, I. and Hamori, S., 2005. An Empirical Analysis of FDI Competitiveness in Sub−Saharan Africa and Developing Countries. *Economics Bulletin,* 6 (20), pp. 1−8.

Regan, P.M., Frank, R.W. and Clark, D.H., 2009. New Datasets on Political Institutions and Elections, 1972-2005. *Conflict Management and Peace Science,* 26 (3), pp. 286-304.

Reuber, G.L., Crookel, H., Emerson, M. and Gallais-Hamonno, G., 1973. *Private Foreign Investment in Development*, Clarendon Press: Oxford.

Roe, M.J., 2006. Legal Origins and Modern Stock Markets. *Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series,* 563, pp. 1-55.

Rogoff, K., 1990. Equilibrium Political Budget Cycles. *The American Economic Review,* 80 (1), pp. 21-36.

Root, F.R. and Ahmed, A.A., 1979. Empirical Determinants of Manufacturing Direct Foreign Investment in Developing Countries. *Economic Development and Cultural Change,* 27 (4), pp. 751-767.

Rose, A., 2000. One Market, One Money: Estimating the Effect of Common Currencies on Trade. *Economic Policy,* 30 (1), pp. 7–45.

Rose, A.K. and Engel, C., 2002. Currency Unions and International Integration. *Journal of Money, Credit & Banking,* 34 (4), pp. 1067-1090.

Rose, A.K. and VAN Wincoop, E., 2001. National Money as a Barrier to International Trade: The Real Case for Currency Union. *American Economic Review,* 91(2), pp. 386-390.

Rugman, A.M., 1998. Multinational Enterprises and Public Policy. *Journal of International Business Studies,* 29 (1), pp. 115-136.

Rugman, A.M., 1999. Forty Years of the Theory of the Transnational Corporation. *Transnational Corporations,* 8 (2), pp. 51-70.

Sahoo, P., 2006. Foreign Direct Investment in South Asia: Policy, Trends, Impact and Determinants. *Asian Development Bank Institute (ADBI) Institute*, 56, pp. 1-76.

Santa-Clara, P. and Valkanov, R., 2003. The Presidential Puzzle: Political Cycles and the Stock Market. *Journal of Finance,* 58 (5), pp. 1841-1872.

Schiavo, S., 2007. Common Currencies and FDI Flows. *Oxford Economic Papers,* 59 (3), pp. 536-560.

Schneider, F. and Frey, B.S., 1985. Economic and Political Determinants of Foreign Direct Investment. *World Development,* 13 (2), pp. 161-175.

Shin, Y. S., 1998. *European Integration and Foreign Direct Investment in the EU: The Case of the Korean Consumer Electronics Industry,* London: Routledge , 86-108

Silva, J.M.C.S. and Tenreyro, S., 2010. Currency Unions in Prospect and Retrospect. *Annual Review of Economics,* 2, pp. 51-74.

Sims, C.A., 1994. A Simple Model for Study of the Determination of the Price Level and the Interaction of Monetary and Fiscal Policy. *Economic Theory*, 4, pp. 381-399.

Sinha, U.B., 2010. Strategic Licensing, Exports, FDI, and Host Country Welfare. *Oxford Economic Papers*, 62, pp. 114–31.

Sinn, H.-W., 2012. The European Balance Of Payments Crisis, CESifo Forum 0112, Special Issue 1, January. The State Bank of Vietnam. Available from: http://www.imf.org/external/pubs/ft/seminar

Spar, D.L., 2009. National Policies and Domestic Politics. *In:* Rugman, A.M., 2nd ed., *The Oxford Handbook of International Business.* Oxford University Press: New York.

Studenmund, A.H., 2011. *Using Econometrics: A Practical Guide.* Pearson: Boston.

Tahir, R. and Larimo, J., 2004. Understanding the Location Strategies of the European Firms in Asian Countries. *Journal of American Academy of Business,* 5 (1/2), pp. 102-109.

Tallman, S.B., 1988. Home Country Political Risk and Foreign Direct Investment in the United States. *Journal of International Business Studies,* 19 (2), pp. 219-234.

Taylor, C.T., 2000. The Impact of Host Country Government Policy on US Multinational Investment Decisions. *World Economy,* 23 (5), pp. 635-647.

Te Velde, D.W. and Bezemer, D., 2006. Regional Integration and Foreign Direct Investment in Developing Countries. *Transnational Corporations,* 15 (2), pp. 41-70.

Tenreyro, S. and Barro, R.J., 2003. Economic Effects of Currency Unions. *NBER working paper,* 9435, pp. 1-30.

Thomas, D.E. and Grosse, R., 2001. Country-of-Origin Determinants of Foreign Direct Investment in Emerging Market: The Case of Mexico. *Journal of International Management,* 7 (1), pp. 59-79.

Tolentino, P.E., 2010. Home Country Macroeconomic Factors and Outward FDI Of China And India. *Journal of International Management,* 16 (2), pp. 102-120.

Tomohara, A. and Takii, S., 2011. Does Globalization Benefit Developing Countries? Effects of FDI on Local Wages. *Journal of Policy Modeling*, 33, pp. 511–521.

Tortian, A.Z., 2007. International Investment Agreements and Their Impact on Foreign Direct Investment: Evidence from Four Emerging Central European Countries. Thesis (PhD). The Paris-Sorbonne University.

Trevino, L.J. and Mixon, F. G., 2004. Strategic Factors Affecting Foreign Direct Investment Decisions by Multi-National Enterprises in Latin America. *Journal of World Business*, 39, pp. 233-243.

Tsai, P-L., 1994. Determinants of Foreign Direct Investment and its Impact on Economic Growth. *Journal of Economic Development,* 19 (1), pp. 137-163.

Tuman, J.P. and Emmer, C.F., 1999. Explaining Japanese Foreign Direct Investment in Latin America, 1979-1992. *Social Science Quarterly,* 80 (3), pp. 539-555.

Tuman, J.P. and Emmert, C.F., 2004. The Political Economy of U.S. Foreign Direct Investment in Latin America: A Reappraisal. *Latin American Research Review,* 39 (3), pp. 10-28.

UNCTAD STAT, 2010a. United Nations Conference on Trade and Development Statistics. Available from:

http://archive.unctad.org/Templates/Page.asp?intItemID=1584&lang=1 [Accessed October 2010].

UNCTAD STAT, 2010b. United Nations Conference on Trade and Development Statistics. Available from: http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx?sCS_referer=&sCS_ChosenLang=en [Accessed October 2011]

UNCTAD, 1991. *World Investment Report 1991: The Triad in Foreign Direct Investment.* United Nations: Switzerland.

UNCTAD, 2002. *World Investment Report 2002: Transnational Corporations and Export Competitiveness.* United Nations: Switzerland.

UNCTAD, 2007. *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development.* United Nations: Switzerland.

UNCTAD, 2008. *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge.* United Nations: Switzerland.

UNCTAD, 2009. *World Investment Report 2009*: *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries.* United Nations Publication: Switzerland.

UNCTAD, 2011a. *World Investment Report 2011: Non-Equity Modes of International Production and Development*. United Nations: Switzerland.

UNCTAD, 2011b. Inward FDI Performance Index - Results for 2005-2007. Geneva: UNCTAD. Available from: http://www.unctad.org/templates/webflyer.asp?intitemid=2471&lang=1 [Accessed April 05, 2011]

UNCTAD, 2011c. Outward FDI Performance Index - Results for 2005-2007. Geneva: UNCTAD. Available from: http://www.unctad.org/templates/WebFlyer.asp?intItemID=3241&lang=1 [Accessed April 05, 2011]

United Nations Statistics Division, 2012. http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=14&Lg=1 [Accessed June 30, 2012].

UNCTAD, 2013. *World Investment Report 2013: Global Value Chains: Investment And Trade For Development.* United Nations: Switzerland.

United Nations, 1999. The CFA Franc: New Peg for a Common Currency. *Africa Recovery,* 12 (4), pp. 27.

USAID, 2007. Foreign Direct Investment: Recent Trends and Implications for USAID. *USAID from the American People,* pp. 1-7. Downloadable from: http://pdf.usaid.gov/pdf_docs/PNADK049.pdf.

Vamvakidis, A., 1998. Explaining Investment in the WAEMU. *IMF Working Paper,* WP/98/99, pp. 1-23.

Venables, A.J., 1999. Regional Integration Agreements: a Force for Convergence or Divergence? *Policy Research Working Paper Series,* 2260, pp. 1-29.

Vernon, R., 1966. International Investment and International Trade in the Product Cycle. *The Quarterly Journal of Economics,* 80 (2), pp. 190-207.

Vijayakumar, N., Sridharan, P. and Rao, K.C.S., 2010. Determinants of FDI in BRICS Countries: A Panel Analysis. *International Journal of Business Science and Applied Management,* 5 (3), pp. 1-13.

Wei, S-J. and Choi, C., 2002. Currency Blocs and Cross-Border Investment. Mimeo.

Whalley, J., 1998. Why do Countries Seek Regional Trade Agreements? *In:* Frankel, J.A., ed. *The Regionalization of the World Economy.* University of Chicago Press: Chicago, pp. 63-90

White, H., 1980. A Heteroskedasticity-Consistent Covariance Matrix Estimator and a Direct Test for Heteroskedasticity. *Econometrica,* 48 (4), pp. 817-838.

Williams, O. and Williams, S., 1998. Foreign Direct Investment Flows to the Eastern Caribbean Central Bank Region. *Working Papers, Central Bank of Barbados,* pp. 179-94.

Wong, Y.C., and Adams, C., 2002. Trends in Global and Regional Foreign Direct Investment Flows, in Opportunities and Challenges for Cambodia, Laos and Vietnam, Proceedings of the 2002 Conference on Foreign Direct Investment, Hanoi, International Monetary Fund

Woodward, D.P. and Rolfe, R.J., 1993. The Location of Export-Oriented Foreign Direct Investment in the Caribbean Basin. *Journal of International Business Studies,* 24 (1), pp. 121-144.

World Bank, 2011. World Development Indicators. Edition: April 2011. ESDS International, University of Manchester. DOI: http://dx.doi.org/10.5257/wb/wdi/2011-04

World Bank, 2012. World Development Indicators. Edition: April 2012. ESDS International, University of Manchester. DOI: http://dx.doi.org/10.5257/wb/wdi/2012-04

World Trade Organization, 2011. Overview: A Navigational Guide. Geneva: World Trade Organization. Available from: http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm.

Worrell, D., 2003. A Currency Union for the Caribbean. International Monetary Fund.

Worth, T., 2002. Regional Trade Agreements and Foreign Direct Investment. *Regional Trade Agreements and US Agriculture,* Agricultural Economic Report No. 771, pp. 77-83.

Yang, Y. and Gupta, S., 2007. Regional Trade Arrangements in Africa: Past Performance and the Way Forward. *African Development Review,* 19 (3), pp. 399-431.

Yih Yun Yang, J., Groenewold, N. and Tcha, M., 2000. The Determinants of Foreign Direct Investment in Australia. *The Economic Record,* 76, pp. 45-54.

Zimny, Z., 2004. Long-Term Trends in International Production, *EIB Papers,* 9 (1), pp. 26-51.