Host country reforms and FDI inflows: How much difference do they make.

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Summary

This study examines the effects of various policies on foreign direct investment (FDI) flows from the perspective of the â€œeclectic theoryâ€ of international investment, and hence the advantages of foreign ownership, host country location, and internationalization. Host country policies can influence FDI flows primarily through their influence on the advantages of location in the host country. Pooled cross-section and time-series data for 49 less-developed countries (LDCs) over 1970â€“95 are used to examine the effects of several different types of policy/institutional variables, including corporate tax rates, tariff rates, the degree of openness to international capital flows, exchange rate distortions, contract enforcement, nationalization risk, bureaucratic delay and corruption. A multivariate analysis of the effects on FDI flows of each type of policy, with and without controls for other relevant determinants is conducted. Two different sources of FDI data are employed as well as two different measures of capital controls.

Although there are methodological problems in estimation, and especially collinearity problems, and relatively severe availability constraints for some of the relevant measures, the results demonstrate the relevance and importance for FDI flows of many of the policy/institutional variables under study. They also indicate that the results from panel methods yield results that differ rather significantly from those obtained from pure cross-section analysis. Because of complementarity between the various elements of a healthy investment climate, the effects of some policy reforms estimated from models which do not control for changes in other policies may overstate the effectiveness of individual policy reforms.

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Key words

foreign direct investment; corporate tax rates; capital controls; growth; exchange rate distortions; corruption; developing countries; contract enforceability

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