FDI into emerging markets: Do institutions really matter?

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ARTICLE INFO

Article history:

Received 15 August 2020

Received in rev. form 02 Sept. 2020

Accepted 12 September 2020

Keywords:

Institutions, Foreign direct investment,
Emerging Economies, BRIC, Panel
Data

JEL Classification:

F21, O43, E02, H11, K42

ABSTRACT

This empirical paper examines how institutional strengths or weaknesses of emerging markets might affect investment inflows into these countries. The study includes data of 13 emerging economies from different regions. The countries included are Argentina, Brazil, Chile, China, Indonesia, India, South Korea, Mexico, Malaysia, Nigeria, Poland, Russia, and Turkey for the time period 2000-2018. The institutional variables; property rights, good governance, corruption, rule of law, and civil liberties are examined to understand if there is a deviation from the existing literature for the emerging countries. Secondly, we also investigated differences among the emerging countries and asked if non-BRIC countries are different in results. A panel data model has been performed for the analysis. Our findings prove that some institutions such as corruption, civil liberties, property rights, and good governance are significantly important to attract FDI into the emerging markets, as indicated in the literature for the developed countries, but not as strong as assumed. Secondly, other institutional constructs such as rule of law and political stability found to be insignificant in emerging markets. Finally, we found a similar result even when we analyzed emerging markets without BRIC countries.

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Introduction

Advances in communication, transportation and technologies boosted global economy in the last three decades and the transformations toward liberalization, deregulation and market system gave rise to the internationalization of the firms in all around the world. In the recent globalization era, the scope of the global market is also expanded towards the developing countries that several countries and regions benefitted from the advantages of internationalization of investment.

The levels of the Foreign Direct Investment (FDI) that has reached very high levels in both in advanced and emerging economies is a good indicator to fully comprehend the transformation of the global economy in the 2000s. According to UNCTAD World Investment Report (2020), global FDI flows has reached to \$2 trillion peak level in 2015, that indicated a good recovery after the global recession of 2008. Similarly, the share of FDI flows to emerging countries has reached roughly half of the total global inflows which demonstrates the striking role and importance of the emerging economies for hosting FDI. In other words, global production has slowly shifted toward the emerging markets, particularly to the Asia. On the other hand, the increase in FDI levels has slowed down all around the world in the second decade of the millennium and the increasing rate in the share of emerging economies has stopped. Global FDI level contracted to 1.7 trillion in 2017, and 1.5 trillion in 2018. Consequently, the investment level into the developing Asia and Africa has experienced a slight decrease. (UNCTAD, 2020). This would mean for the emerging markets it will get harder to attract FDI into their countries compared to the early years of the 2000s.

Under the lights of these trends in foreign investment levels, it is necessary to explore the determinants of FDI decisions. Particularly, while the global political atmosphere for the globalization trends was changing, analyzing the motivations of FDI inflows into emerging economies become more significant and much more studies are needed in this field. In fact, since the rise of the share of the emerging economies within the total FDI flows in the 2000s a new research interest for the emerging markets, particularly from an international business and economics perspective has started. However, to date, studies are scarce and have been focused mostly to BRIC (Brazil, Russia, India, China) countries. However, due to the peculiar characteristics of each emerging countries and some unique features of the BRIC economies, such as abundance of the population and basic resources, it is not possible to generalize the

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findings of those studies to the other emerging economies. Thus, studies focusing on the other emerging economies are urgently needed. In this regard, the main purpose of this study is to provide a broader understanding on the emerging markets characteristics as destinations of FDI flows. For this purpose, we will focus institutional characteristics of these economies through an extended data for the several emerging countries. Also, we are expanding the period of analysis from 2000 to 2018 observe recent global political economic trends after the global recession. We will seek an answer to the question of how institutional settings of the emerging markets are significant for the foreign investors' location choice and if so, how over time and across each of the emerging countries this attitude varies. In doing so, we will expand the scope of the emerging market studies beyond the BRIC countries and will make a comparison to them. In addition, we will cover an era that would enable us to explore both the rise of global investment levels and the recent new protectionist, anti-globalization trends seen in advanced economies. For the last few years of the analysis, we expect to see the effects of the rise of the economic nationalism for the emerging countries from an institutional perspective of these countries.

Methodologically, this paper uses random effects data. The data is composed of the macroeconomic and institutional variables from various country-level databanks.

The paper is composed of five sections; the second part clarifies the theoretical model on FDI and institutions, and summarizes empirical literature of the theory; the third part explains the data and the empirical model of the research. Section four evaluates empirical results and discusses our findings. And, finally we discuss our contribution to the exiting literature and address the limitations of the study.

Literature Review

Theoretical Background

Development economics has long seen Foreign Direct Investment key to boost savings which are usually under shortage for the desired level of investment in newly emerging economies. In the 1990s, while global growth rates are very high, referencing the abundance of the foreign investment, endogenous Growth theories emerged and emphasized the key role of FDI for economic growth. These theories shed light on the role of FDI in bringing the technology transfer from the developed economies to the developing nations. (Dunning, 1994) Thus, there is a significant amount of literature that focuses on the benefits of FDI for the hosting country.

Thrilled by the advantages of the FDI, many developing countries changed their radial view against the foreign investment and launched facilitating policies to attract FDI flows into their countries such as reducing taxes and providing subsidies. Likewise, structural adjustment programs, financial sector adjustments are adopted to attract more FDI. Thus, several studies also focused on the host country FDI policies (Asamoah, Adjasi & Alhassan, 2016). From the theoretical perspective, in 1988, Dunning proposed the Eclectic paradigm theory to explain the decision of a foreign investor to invest into a country. (Dunning, 1988) The Eclectic paradigm identifies host country location-specific advantages as well as the firm's firm-specific ownership advantages for internalization. He pointed out that in addition to the host country related labor and transportation costs, the institutions, government policies, and political stability are key determinants to calculate the risks and returns before entering a new market (Dunning, 2015).

In the same years, from the field of economics, the relationship between institutions and economic performance has begun to receive more attention from researchers and policy makers. Addressing the limitations of the neoclassical economics to comprehend externalities, new institutional economists pointed the fundamental role of institutions for a better functioning market (North, 1990). Good governance is found to be related to the economic growth that history and sociology matter for the market functioning. Institutions defined as the formal or informal rules of the market transactions game. North (1990) described the institutions as the human design structures for political, economic and social issues.

Empirical Review

Institutions were not easy to measure and there were few studies in the 1990s for the application of the theory. In recent years, thanks to the growing data availability and efforts to indexation of the several social constructs, a more holistic approach has been adopted in institutional studies. Thus, the research on institutions and their impact on the markets evolved to the application of the theory. Empirical studies first create measurement methods and variables for the social, political and economic institutions and then, sought evidence for the significance of the institutions for market efficiency in addition to the strong macroeconomic factors. A significant amount of study in international business literature argued how home country specific factors, particularly its institutional strength explains the multinational's effectiveness. Chan, Isobe & Makino (2008) explored the role of host country institutional factors in firm performance and discussed which country matters more foreign affiliates of the multinationals. Particularly, innovative capability of the host country is analyzed in relation with the firm innovation performance (Phene & Almeida, 2008).

At the country level studies, another stream of research examined the institutional determinants of FDI and the FDI location decisions. As an early study, Wheeler and Mody (1992) investigated the impact of institutions on FDI level. In their study that focus on the location decision of the US multinationals, they did not find significant negative effect of institutional risks such as administrative delays, political instability and corruption on FDI decisions. This study was limited to the American outward FDI and has studied as an early date in terms of the global FDI levels. Later, Kaufmann, Kraay, and Zoido-Lobaton (1999) have focused on the impact of governance on both inward and outward FDI level of countries. They created governance indexes as we also use its updated version

in this study. Most of the studies used specific institutional variables to analyze the impact of FDI levels. For instance, Egger and Winner (2005) focused on corruption with a bilateral dependent FDI data while Globerman and Shapiro (2002) investigated the role of governance infrastructure on investment flows. They found statistical evidence that the good governance is positively and significantly related to the FDI. They argued that same institutional factors have impact on both inward and outward FDI. Thus, they also expanded their study to the outward FDI. In the stream of the good governance research, Mengistu and Adhikary (2011) found positive relationship between good governance, institutional quality, political stability, market friendly institutions and FDI inflows. For corruption, empirical results are mixed. The ‘grapping hand theory’ argues that due to causing increased uncertainty and administrative costs, corruption deters FDI. (Rose-Ackermann, 1975). On the other hand, ‘helping hand theory’ says in the presence of excess regulation corruption may accelerate procedures and stimulates FDI (Huntington, 1968). Empirically, Egger and Winner (2005) found a positive relationship while Mauro (1995) found negative correlation. Peng and Beamish (2008) found conflicting results for developed and developing countries.

Since 2000s, with the acceleration of the global scale integration, there are more studies committed to analyze the rise of the emerging market economies. These studies focus on different characteristics of the emerging markets and compare them to the advanced countries. But, few studies addressed the differences across emerging markets, their differences in institutional settings and their possible differences in their FDI attractiveness. Thus, in this study we will explore empirically differences across emerging countries and the impact of their institutional setting on FDI inflow level.

Research and Methodology

Data, Variables and Methodology

We are seeking to comprehend how the institutional variables and the measures of freedom are related to the FDI flow levels into emerging market economies and how this relationship changes over time. In order to analyze these basic research questions across emerging countries over time, we built a panel data with several variables. The study includes data of 13 emerging economies; Argentina (ARG), Brazil (BRA), Chile (CHL), China (CHN), Indonesia (IDN), India (IND), South Korea (KOR), Mexico (MEX), Malaysia (MYS), Nigeria (NGA), Poland (POL), Russia (RUS), and Turkey (TUR). The data covers the time period from 2000 to 2018.

Our dependent variable is the net inward FDI flows obtained as current dollars and adjusted by the price index to obtain constant numbers. Figure 1 and 2 provides a closer look for our dependent variable, FDI inflows. Due to the scale difference in investment levels of the emerging countries we wanted to observe BRIC countries trends separately. The graphs demonstrate the slow down in foreign investment levels in the last decade. Despite many fluctuations, generally we observe a downward trend in inflows after the recovery of the global recession. This trend might be related to the rise of economic nationalism and regionalization. For instance, Mexico, as a country in the hinterland of the USA continues to an upward trend. The trends observed in our dependent variable makes the research question of this study more interesting. The institutional settings that reverse the general trends for FDI attraction in emerging markets would provide valuable information for both policymakers and researchers.

Graph 1: FDI Inflows by BRIC

Figure 2: FDI Inflows by Emerging Economies

Our main independent variables are ordered variables for the institutional and governance aspects of the countries. These are property rights index (PR), civil liberties (CL) index, voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption indexes. Our model also includes macroeconomic controls such as gdp, gdp per capita, consumer price index, population and merchandise trade.

All the macroeconomic variables including FDI levels are obtained from World Bank World Development Indicators (WDI) database. Property rights and civil liberties data are acquired from Freedom House's freedom in the World database. Other institutional variables are provided by Kauffman et al. (2003)'s World Governance Indicators (WGI) through World Bank.

Table 1 provides summary statistics for the data. Our main dependent variable, logarithmic FDI inflows ranges from 18.6 to 26.4 which shows that the chosen emerging markets do not vary much as FDI recipients when compared with one another. This resemblance might help us to see the role of institutions since institutional setting can play greater role to alternate the destination.

The countries in analysis are all middle income countries and most of them are in upper middle income group.¹ In terms of per capita GDP, China, India, Indonesia and Nigeria remains relatively poor compared to the other countries in analysis. South Korea has the highest per capita income in this group of countries, and Poland and Turkey followed her.

Trade openness, which is reported as merchandise trade as percentage of GDP, also have similar levels for most of the listed countries and mostly ranges around 40 % of GDP, except Malaysia and Poland which have higher openness level compared to rest of the countries; 192 and 70 respectively.

When working population numbers concerned, as known population in India and China surpasses all the other countries around the world. In our logarithmic variable, we have less volatility across nations.

Beyond that, all the other variables we have used in our model are indexed numbers and ranges in their normalized ranges.

Table 2 presents correlation matrix for the variables. We observe high and positive correlation between population and FDI. Property Rights, civil liberties, trade openness and voice of accountability indicates relatively high but negative correlation. The correlation matrix providing significant correlations for our dependent variable is consistent with what we expect from our model.

¹ Since the data is panel, over time we observe change in classifications for each country. Here, we mentioned the average per capita income level of the period 2000-2018.

Table 1: Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max	p1	p99	Skew.	Kurt.
Inward FDI (ln)	263	23.221	1.286	18.558	26.396	20.133	26.315	-.141	3.816
GDP per capita (ln)	266	8.844	.784	6.717	10.195	6.768	10.146	-.916	2.982
Trade Openness	266	53.313	32.602	17.011	192.123	17.357	178.983	2.212	8.448
PropertyRights	266	5.086	1.781	1	7	1	7	-1.053	3.098
CivilLiberties	266	4.861	1.479	2	7	2	7	-.475	2.243
Population (ln)	266	18.482	1.259	16.546	21.055	16.568	21.044	.708	2.699
Voice and Accountability	252	.074	.738	-1.749	1.293	-1.701	1.106	-.705	2.775
Political Stability	252	-.405	.77	-2.211	1.092	-2.13	1.049	-.392	2.519
Government Effectiveness	252	.212	.607	-1.215	1.275	-1.165	1.267	-.045	2.544
Regulatory Quality	252	.146	.66	-1.352	1.539	-1.216	1.506	.201	2.301
Rule of Law	252	-.058	.691	-1.427	1.433	-1.407	1.368	.379	2.335
Control of Corruption	252	-.131	.66	-1.431	1.592	-1.342	1.582	.559	3.139

Table 2: Matrix of Correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
(1) Inward FDI (ln)	1.000											
(2) GDP per capita (ln)	0.060	1.000										
(3) Trade Openness	-0.172	0.280	1.000									
(4) PropertyRights	-0.351	0.211	-0.079	1.000								
(5) CivilLiberties	-0.252	0.365	-0.028	0.921	1.000							
(6) Population (ln)	0.506	-0.689	-0.442	-0.463	-0.562	1.000						
(7) Voice and Accountability	-0.322	0.327	-0.026	0.953	0.947	-0.534	1.000					
(8) Political Stability	0.019	0.648	0.414	0.414	0.582	-0.568	0.549	1.000				
(9) Government Effectiveness	-0.047	0.594	0.612	0.349	0.437	-0.546	0.460	0.803	1.000			
(10) Regulatory Quality	-0.050	0.627	0.469	0.452	0.547	-0.601	0.572	0.740	0.886	1.000		
(11) Rule of Law	-0.092	0.493	0.427	0.524	0.591	-0.517	0.638	0.751	0.904	0.902	1.000	
(12) Control of Corruption	-0.089	0.544	0.346	0.540	0.638	-0.594	0.658	0.794	0.881	0.904	0.934	1.000

Our basic panel regression model is;

$$(1) \text{LnFDI}_{it} = \lambda + \beta \text{IV}_{it} + \psi \text{CV}_{it} + \varepsilon_{it}$$

in which, IV represents model Independent variables and CV is for control variables. When independent variables are written in detail, our regression model is;

$$(2) \text{LnFDI}_{it} = \lambda + \beta_1 \text{PR}_{it} + \beta_2 \text{CL}_{it} + \beta_3 \text{VA}_{it} + \beta_4 \text{PS}_{it} + \beta_5 \text{GE}_{it} + \beta_6 \text{RQ}_{it} + \beta_7 \text{RL}_{it} + \beta_8 \text{CC}_{it} + \psi \text{CV}_{it} + \varepsilon_{it}$$

Where,

PR, *Property Rights index*: Scored 1-7; 1 is the weakest, 7 is the strongest (Reversed from the original data)

CL, *Civil liberties index*: Scored 1-7; 1 is the weakest, 7 is the strongest (Reversed from the original data)

World Governance Indexes: Estimated in standard normal units -2.5 – 2.5; -2.5 is the weakest to 2.5 is the strongest.

- VA, Voice and accountability
- PS, Political Stability
- GE, Government Effectiveness
- RQ, Regulatory Quality
- RL, Rule of Law
- CC, Control of Corruption

Voice and accountability is an index reflecting the democratic score of the country. It captures freedom of speech, association and media as well as efficiency of the checks and balances in the system of a country. There a strong positive relationship found in the empirical literature that the strength of democracy, checks and balances and the level of FDI into that country (Mengistu and Adhikary, 2011). Thus, in our model we will test the relevance of the previous findings for our 13 emerging market economies.

Political Stability measures the possibility of destabilization and unconstitutional interventions to the political system and the likelihood of the terrorism within a country. Confidence is important for the markets. Therefore, long-term investors would prefer an effectively working market in a politically stable country. As a result, we expect a positive relationship in between political stability index and FDI inflows.

Government Effectiveness is a measure to observe the way governments formulate the new policies and how efficiently implement them. A strong and effectively working government would give confidence to the investors, thus a positive relation in between GE and FDI is expected in this study.

Regulatory Quality reflects the government's market friendly policies. Thus, the score decreases when price controls anti-trade policies and government interventions implemented by the government. We would expect higher quality to create more market efficiency that would lead in more foreign investment.

Rule of Law is measurement for the legal system of the country. Contract enforcement quality is key for the foreign investors. Legal system that protects individual's property rights and legal institutions which are credible, stable and fair would favor private investments from abroad. Lee and Mansfield (1996) empirically found evidence for the linkage between an emerging country's intellectual property rights system positively effects on the inward FDI levels into that country. Javorcik (2004) also found similar results for the Eastern European countries' IPR regime and FDI levels. Thus in this study we also expect that stronger legal system will result in higher investment into emerging countries.

Control of Corruption index measures who strictly the punishments are implemented and enforced against unfair against in the market. Oligopolistic interest groups, nepotism, private gainers from public goods are undesirable actors in an effectively working market. The strength of the control will positively effect FDI.

As *control variables* (CV), we followed empirical literature on FDI inflows and used *GDP per capita* as a control for the market demand. This variable will also provide control for the *market-seeking* FDI motivation. For the basic resources of the countries, labor force control is provided by the *working age population* (Population aged between 15-65). Dunning (1993) argued that availability of cheap labor, in other words abundance of the labor force in a country, will decrease production costs and will make that location desirable for *cost-efficiency seeking* FDI.

Trade openness is measured through merchandise trade as percentage of the GDP. In international economics, trade openness and foreign investment has long been seen as substitutes. Trade barriers led in more FDI for the firms which have a strong market in that country with barriers (Head and Ries, 2004). However, in recent years, studies found positive empirical relationship in between openness and FDI. This might be a result of the high level of globalization and the increase in efficiency seeking FDI rather than the

market seeking motivations. Thus, in our model for the emerging economies we expect a positive relationship for the trade openness and FDI inflows.

Regression Results and Findings

Table 3 presents our regression results. There are 3 models presented in the table, the first is pooled data Ordinary Least Squares (OLS) regression model; second is Random Effects Panel model; and the last one is the Fixed Effects Panel model.

OLS method is a simple linear regression model. In our first regression in the table, the data is pooled for all countries and linearly regressed by using ordinary least squares. OLS minimizes the sum of the squares of the differences of the given explanatory variables through a linear function. OLS estimation methods requires several conditions such as exogenous predictors, unbiased estimators, homoscedastic, normally distributed and serially uncorrelated errors. (Wooldridge, 2013) Under these conditions, the method will provide best -minimum variance- mean unbiased estimation results.

On the other hand, panel data has some complexities. There are two dimensions: time t and different entities i . The general form of the panel regression is as;

$$Y_{it} = \alpha + \beta'X_{it} + u_{it}$$

Several assumptions can be made for the entity-specific effects from this basic panel regression model. Fixed effects and random effect models are the most commonly used applications of the panel models (Allison, 2009). Random effects model assumes that unobserved variable α is independent of the all observed variables X_{it} unlike the fixed effect model that would not require it (α_i).

Both model have their restrictions. Fixed effect model do not correctly estimate time-invariant and uses only within-country differences and discards differences between the countries. On the other hand, random effect models are more effective in controls for unobserved heterogeneity. Particularly when the unobserved heterogeneity is time-invariant, such as institutional differences between countries in our panel, random effect would provide more efficient estimators.

Before making inference from the regression results. We also tested for model comparison for all the 3 models presented in Table 3. In order to compare if the OLS is better than panel models, we run the Breusch Pagan LM test. In this test the null hypothesis says the variances across the entities, in our model 'the countries', are zero. That means there is no significant differences across countries. Thus a panel effect is not necessary and a simple OLS model would give accurate regression results for the data. Our Breusch-Pagan LM test result indicates the rejection of the null hypothesis, and we resulted that our model is panel, not OLS.

Secondly we performed Hausman Test to clarify random or fixed effects in panel analysis. Our test statistics can not reject the null hypothesis of the Hausman Specification test, that the model is found to be *random effect*.

Model Robustness Check

After our initial regression model that includes all the variables in the dataset, we found multicollinearity problem in *voice and accountability* variable and dropped it out. After dropping that variable, Variance Inflation Factor (VIF) test for multicollinearity is found to be 7.32, well below 10; rule of thumb which indicates acceptable number for the VIF test.

Moreover, our regressions are robust and controlled for heteroscedasticity. For our dependent variable, we have tested unit root through Im-Pesaran-Shin Unit-root test for panels. Im-Pesaran-Shin unit-root test statistics, p-value found to be 0.00 that we reject the null hypothesis proposing "All panels contain unit roots". Thus, there is no evidence for unit root in our panel.

Thus, our model satisfies all the conditions of a correct panel data.

Our random effect regression provides very remarkable findings. First, our model finds significantly negative relationship between property rights and FDI flows into emerging countries. This finding is the opposite of the previous literature which found positive or insignificant relationship between those two variables. For the analyzed countries, the relationship is found negative in all three models and two of them were significant. Thus, we can conclude that even the impact is not very high (-0.204), for the emerging markets property rights regime has no positive impact on foreign investors location decision. We can consider the path dependency impact of long-term experience in Chinese very weak property rights regime for the multinational firms.

Similarly, *political stability and avoidance from terrorism* is found to be insignificant. This finding also shows us the complexities of the emerging market's political economic situations. Likewise, *government effectiveness* found to be negatively related to the FDI inflows. We can discuss that stronger governments in these countries are not wanted by foreign investors while individual liberties are very desirable.

Our regression found positive significant and relative high, 0.446, relationship between *Civil Liberties* and FDI levels. It provides evidence that individual freedom, rights to speech, right to bargain, freedom for trade unions and organizational rights are seen important by the foreign investors in order more eagerly select a country for their investment.

From the other independent variables, *controls for corruption* is found to be important for the investors. A country is more attractive if it has stronger rules to control of corruption. Beyond that the *enforcement of the rules and regulatory quality* are insignificant. Thus, we could not say that good governance is a significant determinant of FDI in emerging markets.

For the macro economic control variables, our findings follow the literature. *Trade openness* significantly increases the FDI level of a country but the impact is very marginal. For the FDI flows into emerging markets, we conclude that market seeking and cost efficiency seeking motivations are still the main determinant for the international firms. Higher *per capita income* attracts market seekers and abundance of the working *population* also increases FDI levels. These impacts are positive, strong and significant.

Finally, explanatory power of the regression is very high. The model has a R-square of 0.62 which means the model explains %62 of the fluctuations in the FDI levels into the emerging countries.

Table 3: Regression Results (All 13 Emerging Countries)

	(1)	(2)	(3)
VARIABLES	OLS	RE	FE
Property Rights	-0.337*** (0.0786)	-0.204** (0.103)	-0.189 (0.123)
Civil Liberties	0.450*** (0.110)	0.446*** (0.112)	0.514*** (0.120)
Political Stability	0.0507 (0.140)	0.168 (0.180)	0.292 (0.201)
Government Effectiveness	-0.855*** (0.306)	-0.737* (0.389)	-0.574 (0.435)
Regulatory Quality	0.224 (0.217)	0.363 (0.322)	0.439 (0.350)
Rule of Law	-0.508** (0.250)	-0.314 (0.364)	-0.398 (0.459)
Control of Corruption	1.133*** (0.293)	0.553* (0.326)	0.549 (0.345)
Gdp per capita (ln)	1.221*** (0.126)	1.853*** (0.182)	1.859*** (0.321)
Trade Openness	0.0102*** (0.00300)	0.00900** (0.00395)	0.00910** (0.00462)
Population (ln)	1.289*** (0.0800)	1.658*** (0.169)	2.743*** (0.963)
Constant	-12.14*** (2.600)	-25.21*** (4.138)	-45.74*** (15.94)
Observations	250	250	250
R-squared	0.667	0.624	0.423
Number of country		14	14

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

On the other hand, for a more robust analysis on emerging markets as FDI locations, we run the regressions after excluding BRIC countries. As mentioned in previous sections, BRIC countries have some peculiar characteristics, such as very high population – particularly, India and China-, abundance of natural resources Russia and Brazil, and path dependency as FDI location.

Test results for the remaining countries are given in Table 4. In this sample, we have found more significant results for institutional determinants. Other than political stability and property rights all institutional variables found to be significant. Rule of law and government efficiency found to be negatively related to the FDI inflows, but corruption controls stimulate FDI in these countries. Thus, we conclude that corruption control and regulatory quality are desirable from the foreign investors point of view in an emerging market. Investors do not want more government enforcement, but positively reacts to the increases in civil liberties.

Table 4: Random Effect Regression Results (Excluding BRIC Countries)

Inifdi	Coef.	St.Err.	t-value	p-value	Sig
Property Rights	-.213	.147	-1.45	.148	
Civil Liberties	.234	.138	1.70	.09	*
Political Stability	.215	.205	1.05	.295	
Government Effi.	-1.319	.407	-3.24	.001	***
Regulatory Qua.	.593	.296	2.00	.045	**
Rule of Law	-1.149	.327	-3.51	0	***
Corruption Cont.	1.616	.421	3.84	0	***
lngdppc	1.324	.18	7.37	0	***
Trade openness	.011	.004	2.76	.006	***
lnpopulation	1.158	.215	5.39	0	***
Constant	-10.189	4.5	-2.26	.024	**
Overall r-squared	0.409		Number of obs		178.
Chi-square	115.534		Prob > chi2		0.000
R-squared within	0.287		R-squared between		0.661
*** $p < .01$, ** $p < .05$, * $p < .1$					

Conclusions

In this study, we have found very interesting results. First, we have distinctive results on the significance of the institutional strength in emerging markets. For different institutions, we found mixed results. Our findings on property rights, in both full country group and when BRIC countries excluded, are not in support of the main literature on the topic. For the non-BRIC emerging countries, there is no evidence that property rights matter for FDI. For the BRIC countries, it is negatively correlated unlike the literature on developed countries.

The Civic Liberties is significantly and positively correlated with FDI levels of emerging markets in both group analyses. Investors do care about the organizational and individual rights when they consider to invest into an emerging market. Similarly, they also care about the control of corruption level, but other governance measures are not seen significantly encouraging for the investments. Finally, political stability is found to be positively related with the investment level, but the results are also not significant.

Emerging markets are not homogenous countries, neither in terms of their size and factor endowments, nor of their macro-economic stories, and their extent to attractiveness of FDI. But, as the recipient of half of the world investment, we need to learn more about the determinants that affect FDI decisions into these countries. Thus, we reviewed the literature by contributing specific institutional variables. We found that some of the institutional merits are not as significant as considered when it come to the foreign investments. Surprisingly, government efficiency and rule of law which are very desirable in developed countries are not as important as in the case of emerging markets. Only Civil Liberties, individual democratic and organizational rights and the corruption control are exceptions.

Our results raise new questions. Further studies are needed to understand the question of “why”. This study has limitations to answer the reasons why some of the institutions which are significantly important for hosting the FDI in advanced economies are not as important as when it comes to the emerging markets for the same multinationals. Is there any positive externality related to the weak institutions in emerging markets? Why do foreign firms care about the civil liberties in these countries? Will the new anti-globalization trends around the world make institutions more important or not? All these questions needed to be investigated. More research on each of the emerging countries and addressing different institutional variables will expand our knowledge on the emerging markets and their institutions.

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