



Research Article

Foreign direct investment inflows and business cycles

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ABSTRACT

According to the stylized facts of the empirical real business cycle literature, investment is a procyclical variable, i.e. it co-moves with business cycles. Consequently, foreign direct investment's procyclical behavior is hypothesized and tested in this paper. A big sample of 74 (and 65 in the extended model) countries is used, and the hypothesis is tested on quarterly data with an average length of 90 periods, i.e. 22 years. Business cycles are identified by the Hodrick-Prescott filter, and the use of high-frequency data makes the results more precise and reliable. Using fixed effect regressions first the procyclicality of domestic investment is demonstrated, then the cyclical behavior of foreign direct investment is tested. Data shows that FDI is also procyclical. This result is robust, as it takes into account potential confounding variables. The paper's conclusion is that there is significant co-movement between foreign direct investment inflows and the recipient countries' business cycles.

1. Introduction

Globalization and the strengthening of connections between economies gained momentum at the end of the 20th century and have been important phenomena since then. A relevant aspect of globalization is the movement of capital across borders. Foreign direct investment (FDI) started to increase noticeably in the 1990s, and, despite obvious fluctuations in its value, has remained a relevant issue since then. The upper panel of Fig. 1 shows the development of foreign direct investment inflows in the World. FDI flows became relevant in the middle of the 1980s and started to skyrocket in the middle of the 1990s. The value of FDI flows has been growing since then, albeit with huge volatility. Considering the period after the middle of the 1990s, the value of average FDI inflows in terms of GDP is about 3%. According to data from the World Bank, the value of net FDI inflows worldwide was 1.23 trillion US dollars in 2020, which was 1.41% of the world's GDP.

The lower panel of Fig. 1 shows the relationship between constant-price GDP and domestic investment, i.e. gross fixed capital formation. The positive correlation between the two sets of time series is clearly visible: GDP and domestic investment move together. This phenomenon – which is also a well-documented, stylized fact in the real business cycles literature – provides the motivation for the analysis of this paper.

Since foreign direct investment can be viewed as a special type of investment, its co-movement with business cycles can be hypothesized. Why does the cyclical behavior of foreign direct investment matter? Because if foreign direct investment behaves procyclically, it can exacerbate macroeconomic fluctuations, making things more difficult for

economic policymakers. On the other hand, if FDI is countercyclical, it can help smoothing the cycles. So, understanding this phenomenon is interesting both from a theoretical and a policy point of view. Motivated by these facts, the cyclical behavior of foreign direct investment is tested in this paper. Based on the well-documented procyclicality of investment and previous results of the theoretical and empirical literature, the procyclical behavior of FDI is hypothesized. The hypothesis is tested by fixed effects regression models using quarterly data of a large sample countries.

The remainder of this paper is organized as follows. Section 2 gives the definition of business cycles and foreign direct investment, and in addition, presents a brief and focused literature review. Section 3 describes the data in detail and the methodology used to examine the hypothesis. Section 4 shows the procyclical behavior of domestic investment, Section 5 tests the hypothesized procyclical behavior of foreign direct investment. Finally, Section 6 puts forward conclusions.

2. Literature review

Burns and Mitchell (1946) define business cycles as a fluctuation of the aggregate economic activity of nations. Real business cycle (RBC) models – tools to analyze short-run business fluctuations – started to develop in the early 1980s with the seminal paper of Kydland and Prescott (1982). The authors proceeded from growth theory and introduced and aggregated households to analyze their investment-consumption decision and their labor-leisure decision in an endogenous way. Early models focused on technology: Kydland and Prescott (1982) “[...] found if there are persistent technology shocks and the aggregate elasticity of

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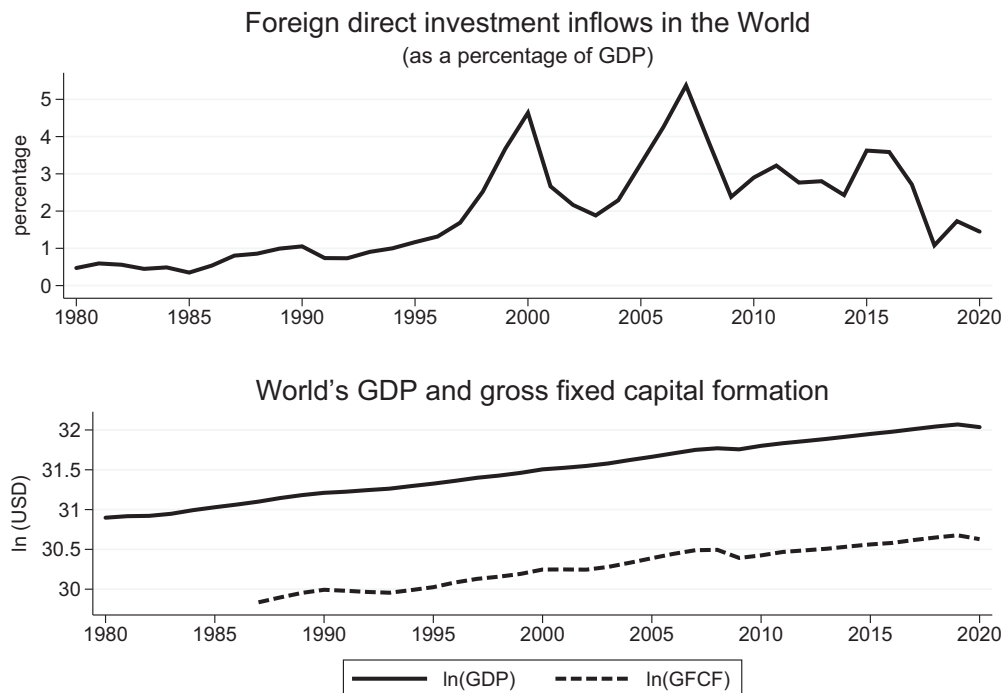


Fig. 1. Foreign direct investment and the procyclicality of investment in the World.
Source: Author's own calculations based on World Bank data.

labor supply is high, neoclassical growth theory can predict fluctuations of the business cycle variety.” (Prescott, 2016: pp. 17) Vecchi (1999), Prescott (2016), and Skare and Stjepanovic (2016) present a detailed review of RBC literature. What is important here, is that the modern RBC literature introduced a new theoretical definition, and so also an empirical method, to define business cycle fluctuations.

There are two main approaches today to identify the recessive and expansive phases of the cycles. The classical approach, i.e. the traditional business cycles analysis – that is also followed by the National Bureau of Economic Research – measures business cycles based on peaks and troughs, i.e. the turning points of the macroeconomic activity. Hamilton (2011) presents a survey of this literature in his paper. On the other hand, motivated by the RBC literature, modern theory – according to Zarnowitz (1992)’s terminology it is called growth cycles – defines cycles as deviations from a long-run trend. The first step is to identify a long-run trend followed by the data. Then, the second step is to calculate the business cycle as a residual: taking the difference between the original and the trend values. This approach followed in this paper.

Burns and Mitchell (1946) also notes that during business cycles many economic indicators move together, so despite the fact that the cycle itself is irregular – i.e. fluctuations are different in their depth and length – there are regularities in the co-movement of macroeconomic indicators. The literature started to investigate these regularities at the very beginning, see for example the famous papers of Stock and Watson (1999), or Benczúr and Rátfai (2010). The most important result of these papers is the identification of so-called ‘stylized facts’ about the co-movement of economic indicators, i.e. phenomena that are generally true for many countries in many periods. One of these empirical stylized facts is that investment (gross fixed capital formation, GFCF) behaves procyclically, i.e. it moves in line with aggregate economic activity, which means that it maintains a significant positive correlation with aggregate real GDP. Fig. 1 also confirms this fact visually, and this is the starting point of this paper.

The OECD defines foreign direct investment (FDI) as “a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor.” (OECD, 2008: p. 17.) Since the economic relevance of FDI is beyond question, a huge strand of literature analyzes the determinant factors of FDI flows. According to previous findings, the most important determinants are the following: exchange rates (Kiyota and Urata, 2004; Xing and Wan, 2004; Froot and Stein, 1991), gross fixed capital formation (Saini and Singhania, 2018; or Economou et al., 2017), inflation rates (Alam and Shah, 2013; Dondashe and Phiri, 2018; Sánchez-Martin et al., 2014), interest rates (Saini and Singhania, 2018; Dondashe and Phiri, 2018; Sánchez-Martin et al., 2014), trade openness (Saini and Singhania, 2018; Blonigen and Piger, 2014; Sánchez-Martin et al., 2014), human capital (Woodward, 1992; Noorbaksh et al., 2001), institutions (Ali et al., 2010; Harms and Ursprung, 2002), and the development of the financial system (Kaur et al., 2013; Desbordes and Wei, 2017).

There is another potential determinant factor which could be considered significant based on the empirical business cycles literature mentioned above. Since investment is procyclical, and foreign direct investment is a special kind of investment, the procyclical behavior of foreign direct investment can be hypothesized. This hypothesis is tested in this paper.

Some theoretical models suggest that foreign direct investment is procyclical. See for example the financial accelerator model of Bernanke et al. (1999), or some open-economy extensions of it, for example Faia (2010). Araujo et al. (2017) offer a detailed survey of the theoretical background.

Surprisingly, the related research is scant and inconclusive. Cavallari and D’Addona (2013) investigate the cyclical behavior – cycles are identified using the Hodrick-Prescott filter – of the outward FDI flows of the USA using fixed effects and random effects regressions. Analyzing 46

partner economies between 1982 and 2009, they find that there a positive correlation between the USA's FDI outflows and the recipient countries' business cycles.

Yeyati et al. (2007) focus on FDI flows to developing countries, originating from the USA, Japan and European OECD countries. They analyze the effect of the source country's business cycles – cycles are defined as a deviation from a log-linear long-run trend – on FDI flows using yearly data from 1980 to 1999, applying fixed effects regression. They get mixed results: outward FDI shows countercyclical behavior when it comes from the USA or the most developed regions of Europe, while behaves weakly procyclical when flowing from Japan to the developing countries.

Araujo et al. (2017) analyze private capital inflows (which is a broader category than FDI) in emerging markets and low-income developing countries, applying fixed effects regression methodology. They show that FDI is acyclical – cycles are identified using the Hodrick-Prescott filter – for both country groups.

Luk and Zheng (2020) show that FDI behaves procyclically in normal times, however this turns into countercyclicality during periods of financial stress. The authors analyze a panel of 11 emerging economies between 1980 and 2015, and they also present a theoretical model that supports their empirical result.

Broner et al. (2013) analyze broad categories of capital flows using a big panel of 103 high-income and middle-income countries over the 1970–2009 sample period. Their main results characterize the broad categories of capital flows, but they also show that FDI inflows decrease in years of crisis, while FDI outflows do not correlate with crisis years.

Doytch (2015) analyzes 15 Asian economies during the period 1980–2011 using dynamic panel models and finds that FDI shows countercyclical behavior. The main result is driven by the service and financial sectors, as mining and manufacturing behave acyclically. Doytch (2021) carries out the same exercise for 19 Eastern European and Central Asian economies and arrives at almost the same result: total FDI inflows are countercyclical, which is maintained by the behavior of the service sector, since other sectors do not show significant co-movement with the business cycles. In both papers the Hodrick-Prescott filter was used to identify business cycles.

Wang and Wong (2007) use a panel of 45 developing and developed countries between 1970 and 2001, and using ordinary least squares and panel regressions they show that business cycles have a negative effect on outward FDI flows. They define business cycles as a residual that can be calculated as the deviation from the expected long-run economic growth path predicted by a model described by Ramey and Ramey (1995).

Lane (2015) analyzes the behavior of international financial flows – and has some results also for FDI – in 41 low-income countries comparing three periods: (i) the global boom between 2003 and 2007, (ii) the crisis of 2007 and 2008, and (iii) the recovery phase between 2010 and 2012. The author surprisingly finds that, comparing to the pre-crisis boom period, FDI inflows were higher during the crises period and did not differ significantly in the post-crisis recovery period. This suggests counter-cyclicality.

Chenaf-Nicot and Rougier (2016) estimate a gravity model for the period between 1985 and 2009 in order to test whether FDI inflows to 4 MENA countries are affected by macroeconomic volatility of the source countries. They find that FDI flows behave procyclically (business cycles were identified by the Hodrick-Prescott filter) both from inward and outward points of view.

Finally, Buch and Lipponer (2005) use annual German firm-level data covering the period 1989–2002 and show that outward FDI co-moves with cyclical developments abroad.

This paper analyzes the connection between inward FDI flows and the recipient country's business cycles, hypothesizing the co-movement of FDI and business cycles, i.e. procyclicality. There are two main pieces of value added in this paper. First, it uses quarterly data that makes possible a more precise measurement of business cycles. While all the papers mentioned above use annual data, in this paper quarterly data is used.

Table 1

Sample size.

	Baseline specification	Extended specification
Number of countries	74	65
Total number of quarters	6626	4077
Number of quarters by countries		
Minimum	18	16
Maximum	168	96
Mean	89.5	62.7
Median	92.5	66.0

Source: Author's own calculations.

Using annual data has the obvious drawback of potentially obscuring a lot of high-frequency information, so with quarterly data, a more precise measurement of business cycles can be applied. Burns and Mitchell (1946) also mentioned in their seminal work that quarterly (or even monthly) data is needed for an appropriate identification: “These statistical efforts represent an important step forward in the measurement of ‘national’ income by short time units and bear considerable promise for the future” (p. 73.). Second, the sample of this paper is also bigger: 74 countries are analyzed in the baseline model, while 65 in the extended model; and the average time span is almost 23 years.

3. Data and methodology

In this paper, 74 countries (in the extended specification – see later – only 65 due to missing data) are analyzed to understand the connection between business cycles and inward foreign direct investment flows. The main source of data is the CEIC database offered by the ISI Emerging Markets Group, although some GDP data is from webpages of national statistics institutes. The panel of countries used here is unbalanced; all the countries are used with their longest time series for which the necessary data is available. Table 1 presents some descriptive statistics about the sample size and the time span of the analyzed countries.

As Table 1 shows the baseline analysis contains 74 countries, from which 33 are developed, 10 are transition and 31 are developing.¹ Countries are analyzed using a relatively long average time span of 90 quarters, which is almost 23 years, covering the 1980–2021 period. Motivated by previous literature on factors attracting FDI an extended model including potential covariates was also estimated. Due to missing data, the sample of the extended model is smaller, containing 65 countries (33 developed, 7 transition, and 25 developing) with an average time span of 63 quarters, covering years between 1996 and 2019.

The main variable of interest is an indicator of the business cycles, which is defined by Hodrick and Prescott (1997) as the deviation of real GDP from its long-run trend. From an empirical point of view, the business cycles of the recipient countries are identified based on deseasonalized constant-price GDP figures using the Hodrick-Prescott filter, following its standard formula:

$$\min_t \left(\sum_{i=1}^T (y_i - t_i)^2 + \lambda \sum_{i=2}^{T-1} [(t_{i+1} - t_i) - (t_i - t_{i-1})]^2 \right)$$

Cycles are calculated by subtracting the natural logarithm of the long-run trend of deseasonalised real GDP identified by the Hodrick-Prescott filter from the natural logarithm of the deseasonalised real GDP. So, cycles are defined as a percentage deviation from the long-run Hodrick-Prescott trend.

Two different estimation equations are used in the paper. First, the procyclical behavior of gross fixed capital formation, i.e. domestic investment is tested by the following equation:

¹ Country classification (developed – transition – developing) is based on the Statistical Annex of UN (2022).

$$GFCF_{it} = \beta_0 + \beta_1 \cdot CYC_{it} + \alpha_i + \varepsilon_{it} \quad (1)$$

where the dependent variable is the gross fixed capital formation as a percentage of nominal trend-GDP (where the trend-GDP is estimated using the Hodrick-Prescott filter) in country i in period t , while CYC is the cyclical component of deseasonalized constant-price GDP (estimated by the Hodrick-Prescott filter) in country i in period t , and so β_1 is the key coefficient measuring the effect of business cycles on domestic investment. Country fixed effects (α) are also included, and ε is the error term.

The hypothesized procyclical behavior of foreign direct investment inflows is tested by a similar equation:

$$FDI_{it} = \beta_0 + \beta_1 \cdot CYC_{it} + \beta_2 \cdot X_{it} + \alpha_i + \varepsilon_{it} \quad (2)$$

where the dependent variable is the FDI inflow as a percentage of nominal trend-GDP (where the trend-GDP is estimated using the Hodrick-Prescott filter) to country i in period t , while CYC is the cyclical component of deseasonalized constant-price GDP (estimated by the Hodrick-Prescott filter) in country i in period t , and so β_1 is the key coefficient measuring the effect of business cycles on FDI inflows. Country fixed effects (α) are also included, and ε is the error term. The term X is a vector of country characteristics, i.e. control variables – and included only in the extended specification –, selected based on the literature of FDI determinants, and includes the following:

- Exchange rate against the USD.
- Gross fixed capital formation as a percentage of GDP.
- Inflation rate, measured by the percentage change of consumer price index.²
- Trade openness, defined as the sum of total export and total import as a percentage of GDP.
- Financial deepness, measured by domestic credit as a percentage of GDP.
- Interest rate, measured by the policy rate (%) of the country's central bank.
- Human capital, captured by the Human Capital Index of the Penn World Table. This data is available only on annual frequency.
- Institutional background, measured by the simple average of the six World Governance Indicator indexes. This data is available only on annual frequency.³

The cyclical behavior of foreign direct investment is tested in three ways, and so three different specifications of equation Equation (2) are estimated, and the results are presented accordingly.

- Baseline specification: equation Equation (2) is estimated excluding the X vector of control variables.
- Extended specification: equation Equation (2) is estimated including the X vector, as well. Control variables are not available for all the country-quarters of the sample, so the number of observations here is smaller.

² If the foreign investors' aim is only to produce in the recipient country, but they would like to sell the produced goods in another country, producer price index is more relevant than consumer prices. Since the data used here is not suitable for making such distinctions, in an alternative specification, the producer price index was also used instead of the consumer price index. The results are robust for the two measurements of inflation, the main messages remain the same.

³ The indicator is originally available for 1996, 1998, 2000, and 2002–2020. The missing values for the years 1997, 1999, and 2001 were imputed as the average of the values of the previous and the next year. Since institutions are typically persistent phenomena (see for example Acemoglu et al., 2001), and considering that institutional background is just a control variable here, these simplifications seem to be acceptable.

- Baseline specification using the estimation sample of the extended specification.

Country fixed effects are included, and clustered standard errors are used in all the specifications. Results are similar using pooled OLS.

4. Results: the cyclical behavior of domestic investment

First, the cyclical behavior of gross fixed capital formation – i.e. investment – is tested. Domestic investment is measured here as the percentage of nominal trend-GDP. The whole-sample average is 22.8 (with a standard deviation of 6.2), which is consistent with the general experience: investment is about 20–25% of the GDP – of course, with heterogeneity across countries. As it was mentioned in the literature review section, procyclicality is hypothesized. Table 2 shows the results of the pooled OLS and the fixed effect specifications.

As Table 2 shows, there is strong evidence for the procyclical behavior of domestic investment. In both the pooled OLS and the fixed-effect specifications, a statistically significant and positive coefficient was estimated which means that gross fixed capital formation co-moves with business cycles. Based on this result, let us now turn to the analysis of foreign direct investment.

5. Results: the cyclical behavior of foreign direct investment

Fig. 2 presents the Pearson's correlation coefficient between foreign direct investment in terms of nominal trend-GDP and the cycle component of the constant-price GDP for each country or region, categorized by continents: Europe, Asia and other.

As Fig. 2 shows, the correlation between inward FDI flows and business cycles is positive for most of the countries, i.e. they show procyclical behavior. Panel regression estimation confirms this result as well, as Table 3 shows. Table 3 contains the results for the different specifications of equation Equation (2) described in Section 3. The first column – Specification 1 – shows the results of the baseline specification, where only country fixed effects were included and no other control variables (so vector X containing the FDI inflow-relevant country characteristics is omitted). The coefficient of the cyclical component is significant and positive which confirms the message of Fig. 2: business cycles have a significant positive effect on inward FDI flows.

Although the unconditional correlation coefficients shown in Fig. 2, and in addition, the baseline results in the first column of Table 2 allow us to gain some useful insight regarding the cyclical behavior of foreign direct investment, these results can nevertheless be biased, since as was explained in Section 2, previous literature has identified many potential factors that can also affect capital movements. Including these confounding variables can help to mitigate the potential bias.

The last two columns of Table 2 present the results of the smaller sample using the country-quarters for which all the necessary control variables are available described in Section 3. It can be seen in the last column (here, vector X is omitted) that results hold on the smaller sample as well: business cycles positively and statistically significantly affect FDI inflows. Including the potential covariates (vector X) – see Specification 2

Table 2
Regression results about the cyclical behavior of gross fixed capital investment.

	Pooled OLS	Fixed-effect
Cyclical component of GDP	0.433*** (0.042)	0.434*** (0.042)
Country FE	no	yes
(Within-) R ²	0.051	0.077
Number of countries	74	
Number of country-quarters	6626	

Note: Estimations based on equation Equation (1). Dependent variable is the value of gross fixed capital formation as a percentage of trend-GDP. *** = significant on 1%. Clustered standard errors are presented in parentheses.

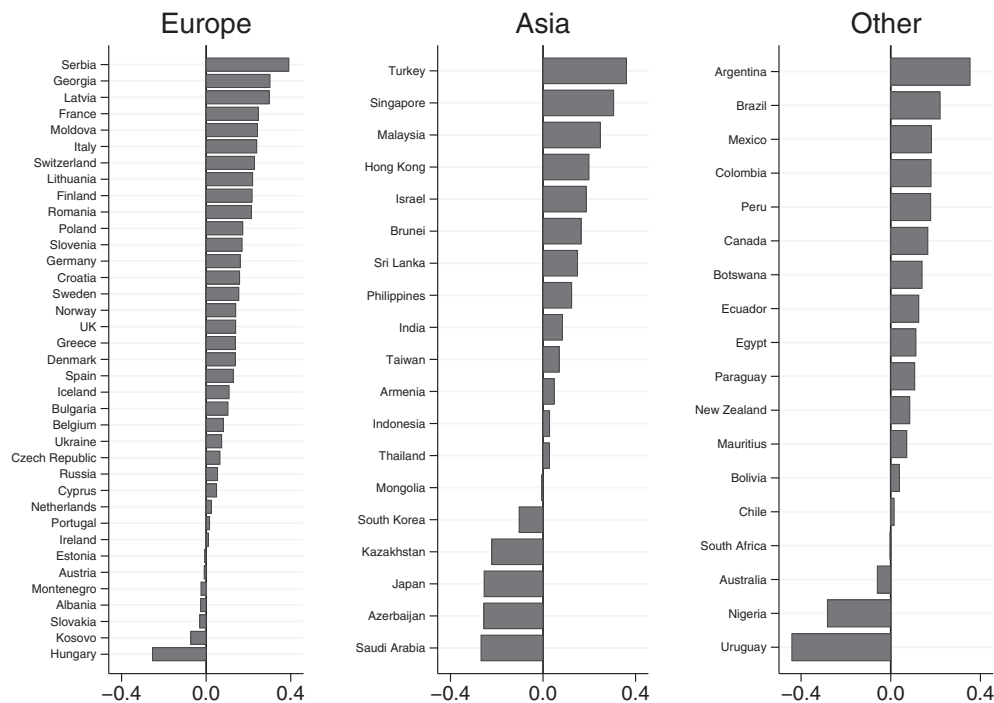


Fig. 2. Pearson's correlation coefficient between FDI inflows and business cycles.
Source: Author's own calculations.

Table 3
Regression results about the cyclical behavior of FDI.

	Specification 1: Baseline	Specification 2: Extended	Specification 3: Baseline spec. on extended spec's sample
Cyclical component of GDP	0.151** (0.070)	0.205*** (0.068)	0.204*** (0.076)
Control variables (vector X)	no	yes	no
Country FE	yes	yes	yes
Within R2	0.000	0.005	0.000
Number of countries	74	65	
Number of country-quarters	6626	4077	

Note: Estimations based on equation. Dependent variable is the value of inward FDI flows as a percentage of trend-GDP. Clustered standard errors are presented in parentheses. *** = significant on 1%, ** = significant on 5%. The coefficients of the extended model's control variables (see Specification 2 in the third column) are presented in Table A1 in the Appendix.

in column 2 – does not change the results either, the coefficient of business cycles is still positive and statistically significant. So, all the three models suggest the same: robust evidence for the procyclical behavior of FDI inflows.

The timing of FDI relative to the business cycles is also assessed in order to identify the leading, lagging, or coincident behavior of foreign direct investment flows. Equation (2) was estimated using lags and leads of the business cycle variable up to 4 quarters.⁴ Results are presented in Table 4.

As Table 4 shows, there are some significant lead and lag coefficients, although the most robust evidence suggests that FDI is a coincident

⁴ Regressions were estimated for higher (5, 6, 7, and 8) leads and lags too, but all coefficients are insignificant.

Table 4
The timing of FDI flows: lagging and leading behavior.

FDI inflows' lagging behavior					
	FDI _t	FDI _{t+1}	FDI _{t+2}	FDI _{t+3}	FDI _{t+4}
Baseline model					
Cyclical component of GDP in <i>t</i>	0.151** (0.070)	0.179*** (0.054)	0.111** (0.053)	0.051 (0.399)	−0.002 (0.075)
Extended model					
Cyclical component of GDP	0.205*** (0.068)	0.166** (0.079)	0.053 (0.081)	0.043 (0.120)	−0.088 (0.179)
FDI inflows' leading behavior					
	FDI _t	FDI _{t-1}	FDI _{t-2}	FDI _{t-3}	FDI _{t-4}
Baseline model					
Cyclical component of GDP	0.151** (0.070)	0.159*** (0.059)	0.076 (0.074)	0.113** (0.051)	0.063 (0.083)
Extended model					
Cyclical component of GDP	0.205*** (0.068)	0.173 (0.118)	0.176* (0.095)	0.174* (0.090)	0.056 (0.153)

Note: Estimations based on equation. Dependent variable is the value of inward FDI flows as a percentage of trend-GDP. Clustered standard errors are presented in parentheses. *** = significant on 1%. ** = significant on 5%. * = significant on 10%.

variable, i.e. it moves simultaneously with the business cycles. The biggest significant coefficients in the extended model are the ones in the first column, where FDI is regressed on the cycle component from the same quarter.

6. Conclusion

A well-documented fact of real business cycles is that investment behaves procyclically, i.e. it co-moves with the fluctuations of the macroeconomy. In this paper a special kind of investment, foreign direct investment was analyzed, and its procyclical behavior was hypothesized. The related literature is limited and inconclusive, and all the cited papers share a common drawback: they use annual data. In this paper quarterly

data of 74 (and 65 in the extended specification) countries was used, which allows of a more precise measurement of business cycles. Fixed effect regression was used, and first, the procyclical behavior of gross fixed capital investment was shown. Then, the cyclicity of inward foreign direct investment was tested. According to the unconditional correlation coefficients, and a simple baseline specification, the null of procyclicality cannot be rejected. Results are robust; controlling for potential confounding variables does not change the message of the baseline model: business cycles have a significant and positive effect on FDI inflows. The conclusion of the paper is that foreign direct investment inflows are procyclical, i.e. they show co-movement with the recipient country's business cycles. This result is important in two main respects.

Appendix

The following countries or regions are used in the paper: Albania, Argentina, Armenia, Australia, Austria, Azerbaijan, Belgium, Bolivia, Botswana, Brazil, Brunei, Bulgaria, Canada, Chile, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Ecuador, Egypt, Estonia, Finland, France, Georgia, Germany, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Kazakhstan, Kosovo, Latvia, Lithuania, Malaysia, Mauritius, Mexico, Moldova, Mongolia, Montenegro, Netherlands, New Zealand, Nigeria, Norway, Paraguay, Peru, Philippines, Poland, Portugal, Romania, Russian Federation, Saudi Arabia, Serbia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Spain, Sri Lanka, Sweden, Switzerland, Taiwan, Thailand, Turkey, Ukraine, United Kingdom, and Uruguay. Note: Due to errors in their GDP or FDI data Belarus, Luxembourg, and Malta were dropped from the sample during the data cleaning process.

Table A1
Detailed results of the extended specification

Variable	Coefficient (and SE)
Cyclical component of GDP	0.205*** (0.068)
Exchange rate (against the USD)	−0.005 (0.003)
Gross fixed capital formation (as percentage of GDP)	0.000 (0.000)
Inflation rate (percentage change of the CPI)	0.381 (0.277)
Trade openness (sum of export + import as a percentage of GDP)	−0.012 (0.040)
Financial deepness (domestic credit as a percentage of GDP)	0.013 (0.012)
Interest rate (central bank's policy rate)	−0.028 (0.335)
Human capital (PWT's Human Capital Index)	−5.828 (5.432)
Institutional background (average of the World Governance Indicators)	8.665 (5.372)

Note: Results refers to Table 3 in Section 5. Estimations based on equation. Dependent variable is the value of inward FDI flows as a percentage of trend-GDP. Clustered standard errors are presented in parentheses. *** = significant on 1%.

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