The University of Chicago

What are the key conditions necessary to attract Foreign Direct Investment? Developing an empirical model for the Latin American reality

By Juan Paulo Bambach Vial

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Faculty Advisor: Eduardo Montero
Preceptor: Manuel Cabal

Abstract

In this paper, we try to understand what the key drivers for FDI in Latin America are and resolve long standing debates. Doing an analysis on nineteen Latin American countries during the period 1990-2009, we compare the effect of liberal economy reforms made during these years in the region with other important variables like demography, democracy, legal certainty, and human development. The liberal reforms effects are evaluated through the Structural Reform Index (STR), a variable created by Eduardo Lora to measure how reformist in liberal policies each country was during the period 1985-2009. The results show that STR has importance in the short term, but not in the mid and long term. Financial Market Development, Rule of Law, and Human Development are the most relevant variables for investors to take investment decisions in the long term.

I. Introduction

From the mid-1980s to the first decade of the 21st century, Latin America experienced a surge of liberal economic policies aimed at attracting foreign investment. This shift was driven by the "Washington Consensus" and involved a move away from more protectionist models with greater state involvement, towards lower tariff rates and greater private sector participation.

While the extent of these policy changes varied across the region, they were widespread. For example, average import rates fell from 42.2% in 1985 to 13.2% in 1991, and less than 10% by 2005, with each country reducing their rates by at least 15% during this period[1]. Liberal

[1] Eduardo Lora, *"Structural reform in Latin America: What has been reformed and how it can be quantified"* (Washington D.C.: IDB Working Paper Series, 2012), 3-25.

reforms in this period also involved drastic changes in banking, taxation, and labor, with the hope of attracting FDI and spurring economic growth.

In the banking sector, minimum reserves required for banks were reduced, and controls on interest rates in private institutions were dismantled between the late 1980s and 1995. This was accompanied by the adoption of international banking regulations, such as Basel standards. However, some of these reforms were reversed after the year 2000. Additionally, the privatization of public banks was authorized, allowing for the entry of foreign capital and the opening of the universal banking system with fewer restrictions[2]

In terms of taxes, the Washington Consensus inspiration line was neutrality, legal and administrative simplification, and the highest revenues. Between 1980 and 2000, the base tax for the revenue went from being on average 18% to 6.7% and being 2.6% of GDP to 1.7%. To moderate the distortions that these changes generated, most countries applied value Added Taxes (VAT), which differ in magnitude and type of affected products in each of these countries. The fees to personal income were also counted, and only a few countries were left with maximum marginal rates greater than 30%[3].

The privatization of different sectors of the economy was also promoted, mainly in the infrastructure sector. In Brazil and Argentina, privatizations reached US$61 and US$25 billion in the process. Bolivia and Chile were also one of the most active in this, especially in the infrastructure sector, where they reached 51% and 37% of GDP respectively. The process extended beyond 2000, and by 2010, 26% of the region's GDP had been privatized.

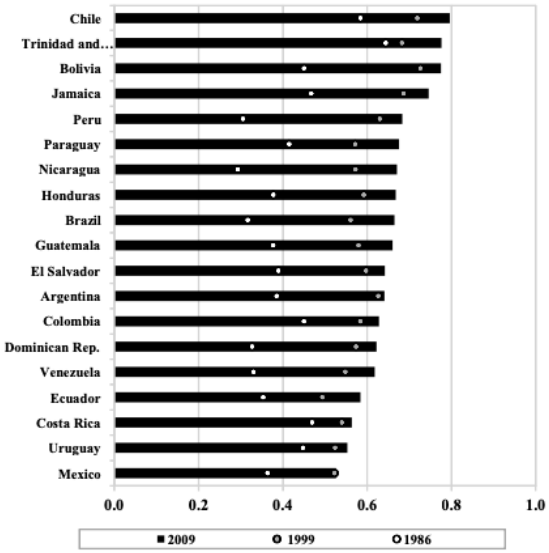
[2] Eduardo Lora, *"Structural reform in Latin America: What has been reformed and how it can be quantified"* (Washington D.C.: IDB Working Paper Series, 2012), 3-25.
[3] Idem.

Finally, regarding the labor market, the reforms were few and only occurred in some countries such as Argentina, Colombia, Guatemala, Panama, Peru, and Venezuela. These were focused on reducing dismissal costs and facilitating the temporary hiring of workers. But in general, most of the countries were developing public policies that promote labor formality and thus enhance social security.

Eduardo Lora, in his study "Structural Reforms in Latin America", builds a Structural Reform Index that analyzes how liberal reformist 19 Latin American countries were in certain areas of the economy during the period 1985-2009. His index includes many financial and economic reforms done during the period, like import tariff reduction, privatization of public goods, reduction of the tax burden, financial market openness, and a flexibilization of labor regulation.

During the period, the average reform index in the analyzed countries, which is measured on a scale of 0 to 1, pass from 0.39 in 1985 to 0.65 in 2009, being Chile the most reformist in the period, with a level of 0.8, and Mexico the one with fewer reforms, 0.5, principally affected for the nulls reforms during the first decade of the 2000s (Figure 1). These numbers are used by Lora to explain the effect of FDI attraction, being the more reformist countries the ones which attract more investment during the period.

Figure 1
Structural Reform Index, 1986, 1999, and 2009[4]



Although the reforms were not equal throughout the continent, more economically liberal in one country than in another. For example, in personal income tax, Chile maintained the highest rates in the region (35%), while in corporate income tax, it was one of the countries with the lowest rate (between 10% and 17%). Based on this and analyzing all the policies that were applied in this period and the disparate effect they had on attracting investment, the question arises as to what other factors are influencing when it comes to attracting foreign capital in Latin America and insofar as each one affects the behavior of investors.

The case of economic transformation in Latin America during the last stage of the 20th century and the beginning of the 21st century is a good case study to measure the variables that affect investment. For example, Chile, Trinidad and Tobago, and Bolivia had the most liberal reforms of the period, but with rather mixed results. On the other hand, Costa Rica, Uruguay, and

[4] Eduardo Lora, *"Structural reform in Latin America: What has been reformed and how it can be quantified"* (Washington D.C.: IDB Working Paper Series, 2012), 30.

Mexico were the ones that applied the most conservative reforms, but they did not have the worst results in attracting foreign capital.

This paper seeks to investigate the impact of these changes described previously on Foreign Direct Investment (FDI) in the region. Starting from the analysis done by Lora in his article, the puzzle that I will try to answer is why countries that apply liberal economic policies are not necessarily equally successful in attracting investment.

My argument is that an economy with more liberal aspects and openness to the world is more likely to attract investment, but that this factor is not necessarily the determining one in attracting foreign investment. Also exist others that drive or stop the flow of capital even with greater force, like democracy, political stability, corruption, regulatory complexity, or human capital. In a liberalized world, with deep access to capital markets, investors are aware of many institutional aspects that not also give a return on their investment, but also certainty.

In the following work, we analyze the effect of different variables on FDI attraction during two different periods, 1990-2009 and 1996-2009. The aim is to compare the effect of the Structural Reform Index created by Eduardo Lora with the effect of other kind of variables on the FDI. We considered variables such as foreign exchange rate, criminality, population growth rate, democracy legal certainty, and human development.

To see these effects, we take the FDI in different years after these variables change. These results suggest that in the short term, investors moved for liberal conditions, like the ones studied by Lora: inflation, trade fares, and exchange rate, among others. But in the mid and long term, structural factors like financial market development or rule of law, are the most relevant for investors.

Conclusions make sense with the long-term view that investors have in big amounts of investments, like projects in mining, energy, water, or transport sector, where they look for good leverage conditions and effective rules. In the same idea, Velasco and Navia (2003), in their study "The Politics of Second-Generation Reform", they see that all the reforms promoted in the "Washington Consensus" do not necessarily overlap and were implemented in two stages, the second group deeper and more structural than the first ones. Reforms of the second group have a focus on legal and political institutions, regulatory entities, anti-corruption, and other structural.

"Just as George Orwell's animals are equal, but some are more equal than others, Latin America´s countries are all underdeveloped, but some a great deal more so than others. This difference can be attributed to varying endowments and initial conditions but also to widely varying policy regimes. The political determinants of such policy options, and the political circumstances that make policy reform more or less likely, are the very big topics to which we now turn"[5]. Similar to our conclusions but with another focus, the study's authors state that the second group of reforms was very important in determining the countries that consolidated their capacity to attract investment, keep growing, and develop more than their pairs.

The study is distributed in seven sections. Section II of this work will review the literature review of FDI, where we will see its history and the main studies that were analyzed, especially for the definition of the variables to be considered for this study. Then, in Section III, we explain the puzzle to study. In Section IV we review the dependent and independent variables to be

[5] Velasco, Andres and Navia, Patricio, *"The Politics of Second Generation-Reform"* (Washington D.C.: Institute of International Economics, 2003), 272-273.

studied, the econometric analysis is carried out, and finally, we will evaluate the results. Section V is a revision of different countries experiences attracting FDI and the policies that they implemented to success. Finally, in Section VI we present the main conclusions of the thesis, and in Section VII are the references of the study.

II. Literature Review

According to the OECD library, Foreign Direct Investment is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy[6]. FDI is the sum of equity capital, long-term capital, and short-term capital as shown in the balance of payments.

Peter J. Buckley, in his article "The Theory of International Business pre-Hymer", analyzes the theories on international trade and foreign direct investment before Stephen Hymer published his thesis on the subject in 1960, which is considered as the beginning of the theory on international business[7]. According to Buckley, the first to talk about foreign investment was C.K. Hobson in "The Export of Capital", who in 1914 analyzed all the theoretical issues related to foreign investment, analyzing the different investment methods between British and American capital in Canada. Despite not making a clear separation between direct and portfolio foreign investment, which complicates the analysis of variables such as rates, exports, the balance of trade, and emigration, it does manage to capture the emerging multinational firms and their problems with political boundaries[8].

[6] OECDi Library, https://www.oecd-ilibrary.org/ .
[7] Peter J. Buckley, *"The theory of international business pre-Hymer"* (Leeds: Journal of World Business, 2010), 61.
[8] Peter J. Buckley, *"The theory of international business pre-Hymer"* (Leeds: Journal of World Business, 2010), 67.

Useful for our future analysis is the article of F.A. Southard (1931), "American industry in Europe", mentioned by Buckley in his study. In the chapter "Why American Industry Migrates to Europe", Southard examines a list of variables of the theory of FDI: (1) Cost Factors: high tariffs, transportation, raw materials and fuel, wages, and taxation; (2) Supplement to home activities: raw materials, intercontinental services; (3) Servicing: catering to national peculiarities; (4) Expansion: patent exploitation; market control and (5) Nationalism (the desire of European countries to purchase local services and products)[9].

Looking at the text that served as the origin of the paper, the IDB researcher Eduardo Lora, in "Structural Reform in Latin America", explains the different liberal reforms that were made in the period that we are covering. He builds a Structural Reform Index for 19 Latin American countries, considering the main economic aspect that was reformed during this period: i) trade policy, ii) financial policy, iii) tax policy, iv) privatizations, and v) labor legislation.

Each of these variables is generated for sub-variables. For example, financial policy is made by bank reserve ratios, freedom of interest rates, taxes on financial transactions, and quality of banking supervision. The index is intended to reflect the degree of neutrality of economic policies in these five areas, in a range from 0 to 1 for each policy variable[10].

Regardless that the analysis was focused on defining the size and effect of these structural reforms on each country, some of the results would be very useful for a future variable's consideration. For example, among the countries that had the deepest liberal reforms were Bolivia, with an indicator close to 0.8, while one of the most conservative was Mexico, with an

[9] Peter J. Buckley, *"The theory of international business pre-Hymer"* (Leeds: Journal of World Business, 2010), 67.
[10] Eduardo Lora, *"Structural reform in Latin America: What has been reformed and how it can be quantified"* (Washington D.C.: IDB Working Paper Series,2012), 26.

indicator of 0.5 (Figure 1). However, during that same period, the investment flow to GDP was very similar between the two countries, but Mexico's GDP was almost 50 times higher[11].

In his paper "Factors that Affect Foreign Direct Investment", Jose Ortiz Adame makes a qualitative analysis of the main variables, internal and external, that have a positive or negative impact on the flow of foreign capital. He considers several of an economic nature, such as economic freedom, taxes, and the exchange rate, but also different ones, such as political reforms, legal certainty, and property rights.

Considering internal economic factors first, the author mentions "financial openness", "deregulation of goods" (privatizations), "controlled inflation", "economic instability", "exchange rate", "free flow of capital", and " trade release". For example, he mentions the relevance of the fall in markets and financing in the US and Europe during the subprime crisis in the investment boom in countries like China, or how the commercial and financial opening affected the Asian giant to position itself as one of the leaders in growth and investment. He also shows the case of Argentina, with its mismanagement of inflation and the exchange rate, which ended up having a strong impact on the IDE, which rapidly fell and recovered (Figure 2[12]).

Figure 2
FDI Argentina (US$MM)

2001	2002	2003	2008	2010
7,138	5,399	1,652	9,726	6,337

[11] Eduardo Lora, *"Structural reform in Latin America: What has been reformed and how it can be quantified"* (Washington D.C.: IDB Working Paper Series,2012), 3-25.
[12] Jose Ortiz Adame, *"Factors that affect Foreign Direct Investment"* (Ciudad de Mexico: Instituto de Investigación Jurídica UNAM, 2013), 10.

In the other side, exist factors that could be considered as non-economic and that are very relevant, like the "creditor's right", which is basically the "easiness for the fulfillment of the contracts and for the creditors to seize the assets of the debtors they don't pay"[13]. Other relevant ones in the same field that Ortiz mentions are "political reforms", "legal security", and “information transparency”. These factors are closely related to legal certainty, and despite not immediately affecting all sectors equally, it is an aspect that is incorporated into the risk-return analysis of investors. When these aspects are uncertain in the investors' analysis, it is difficult to underweight them even though there are improvements in the country, the dollars leave easily but it is difficult for them to re-enter.

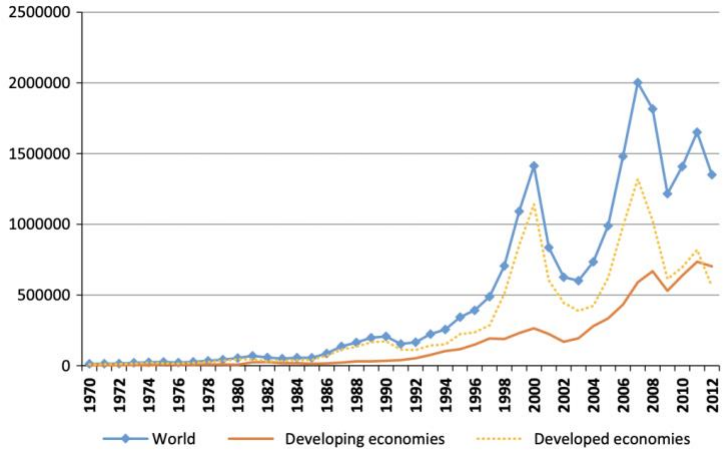
Finally, the author considers “technological advantages” as a new variable for attract FDI. Giving the example of India, where “the software’s industry has growth as a rate of 50% per year since 90s, reaching the second world’s exporter after USA (…) this explains by their educational public policies designed in the 50s oriented to technical studies”[14]. Human capital is also an important aspect considered by investors, and it will be more and more relevant in a higher intensive technological market.

In "Foreign Direct Investment Determinants in OECD and Developing Countries", a group of four economists make an analysis of various aspects that affect foreign investment in twenty-four OECD countries and another twenty-two developing countries between 1980-2012[15]. Analyzing the information in this period, the OECD countries attracted 76% of the world FDI

[13] Jose Ortiz Adame, *"Factors that affect Foreign Direct Investment"* (Ciudad de Mexico: Instituto de Investigación Jurídica UNAM, 2013), 94.
[14] Jose Ortiz Adame, *"Factors that affect Foreign Direct Investment"* (Ciudad de Mexico: Instituto de Investigación Jurídica UNAM, 2013), 106.
[15] Fotini Economou et al., *“Foreign Direct Investment Determinants in OECD and Developing Countries”* (Greece: Review of Development Economics, 2017).

during the period 1990-1999 and 70% during the period 2000-2009. In the case of developing countries, the attraction of investment has been growing since the late 1980s, surpassing that of the developed countries in the analysis during 2012[16]. The analysis is shown in Figure 3[17].

Figure 3
World FDI Inward Flows, (US$ millions)



The authors make a very extensive review of the different variables that affect the FDI according to various studies. Market size, labor costs, taxations, and trade openness are among the most classic variables, but they also include more "innovative" ones such as regulatory quality, corruption control, economic sentiment, and investment climate indicators. Some of them are evaluated by Jayasuriya (2011) using the World Bank indicator "Ease of Doing Business", where FDI is reviewed in 84 countries between 2006-2009, seeing a high correlation between this indicator and foreign investment. Finally, they do a review of others demographic variables, like human capital[18].

[16] Fotini Economou et al., *"Foreign Direct Investment Determinants in OECD and Developing Countries"* (Greece: Review of Development Economics, 2017), 528.
[17] Idem.
[18] Fotini Economou et al., *"Foreign Direct Investment Determinants in OECD and Developing Countries"* (Greece: Review of Development Economics, 2017), 530.

Doing the analysis with these variables for each group, “the empirical results clearly demonstrate that FDI determinants do not have the same effect across different country groups and have important policy implications for the countries aiming to attract FDI inflows in order to promote their economic growth”[19]. Within the quantitative results obtained, they were able to conclude that lagged FDI, market size, gross capital formation, and corporate taxation significantly affect FDI in OECD countries. While in the case of developing countries, lagged FDI, market size, labor cost, and institutional variables provide the most robust results. Results also show that trade openness, schooling, and inflation, don’t show robust effects for any group.

Continuing with the literature related to non-economic factors that affect FDI, Zühal Kurul and A.Yasemin Yalta, in their study "Relationship between Institutional Factors and FDI Flows in Developing Countries", review the relationship between institutional factors and foreign investment . They used "various measures of institutions to identify which aspects of institutional quality affect FDI in the developing world"[20].

In their analysis, they consider a regression where FDI on GDP at t is the dependent variable, and FDI/GDP at t-1, a vector of Institutional Indicators at t, and a vector of potentially influential control variables in t as independent variables. They use World Bank Worldwide Governance Indicators to measure the institutional effect. Among these are Control of Corruption, Government Effectiveness, Political Stability and Absence of Violence, Regulatory Quality, Rule of Law, and Voice and Accountability[21].

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[19] Fotini Economou et al., *“Foreign Direct Investment Determinants in OECD and Developing Countries”* (Greece: Review of Development Economics, 2017), 528.
[20] Zühal Kurul and A. Yasemin Yalta, *"Relationship between Institutional Factors and FDI Flows in Developing Countries: New Evidence from Dynamic Panel Estimation"* (Ankara: Economies, 2017), 1.
[21] Zühal Kurul and A. Yasemin Yalta, *"Relationship between Institutional Factors and FDI Flows in Developing Countries: New Evidence from Dynamic Panel Estimation"* (Ankara: Economies, 2017), 4.

Results show that control of corruption, government effectiveness, and voice and accountability have significant positive impacts on FDI flows, and the remaining three dimensions don't affect significantly FDI inflows. Among the other factors, they observed that FDI in previous years, global risk (global financial crisis included), and trade openness are important variables, as well as global liquidity, exchange rates, financial development, and capital account, has an insignificant effect[22].

In the research titled "Factors Influencing Foreign Direct Investment in BRICS Nations," a team of three economists examines the primary factors influencing investment in Brazil, India, China, and Russia. These countries are all considered emerging economies with substantial populations. The study investigates seven key variables: market size, economic stability and growth prospects, labor costs, infrastructure availability, trade openness, currency valuation, and gross capital formation[23].

The analysis is to do it as BRICS countries, not individually. FDI inflows into BRICS countries are expected to facilitate with an enhancement of market potential, infrastructural development, and capital formation. Also, inflation (economic stability), industrial production (growth perspective), and currency stability are very relevant to attract FDI. On the other side, trade openness and wage rate are not validated as important variables in this study[24].

"How FDI inflows to emerging markets are influenced by country regulatory factors", an article made by four academics, do another approach, trying to solve the questions of "(i)

[22] Zühal Kurul and A. Yasemin Yalta, *"Relationship between Institutional Factors and FDI Flows in Developing Countries: New Evidence from Dynamic Panel Estimation"* (Ankara: Economies, 2017), 5.
[23] Narayanamurthy Vijayakumar et al., *"Determinants of FDI in BRICS countries"* (Puducherry: Journal of Business Science & Applied Management (IJBSAM), 2010), 6.
[24] Narayanamurthy Vijayakumar et al., *"Determinants of FDI in BRICS countries"* (Puducherry: Journal of Business Science & Applied Management (IJBSAM), 2010), 12.

whether and how country-level regulations and institutions influence the choice made by multinational corporations (MNCs) in choosing between countries as investment destinations, and (ii) which regulatory changes (statistically) have the strongest effect on incoming FDI"[25].

In their study, the authors disaggregate a country´s institutional climates into eight sub-indicators using a framework developed by the World Bank: starting business regulations, registering property, getting credit, protection of minority investment, tax regulations, trade across borders, contract enforcement, and resolving insolvency. Using information of IFM and World Bank, they conclude "that starting business regulations, protection of minority investment, and trade across borders indicators have statistically significant effect on FDI inflows/GDP. Registering property, ease of getting credit, taxes regulations, and resolving insolvency are not statistically significant in this model. Taxes regulations and administration is not statistically significant, but its coefficient is positive. Contract enforcement is statistically significant, and its coefficient is negative"[26].

These results show that the variables that affect investment can be of multiple characteristics, some with a liberal nature, such as trade across borders, and others that have a more governmental regulatory nature, such as the ease of starting a business.

Finally, and giving a different perspective, is the article "Corruption and FDI Inflows: Evidence from a Small Developing Economy" from the Jordanian academics Hamad A. Kasasbeh, Metri F. Mdanat, and Raed Khasawneh. This study examines the relationship between FDI and

[25] Farok J. Contractor et al., *"How FDI inflows to emerging markets are influenced by country regulatory factors"* (Manchester: Journal of International Management, 2021), 3.
[26] Farok J. Contractor et al., *"How FDI inflows to emerging markets are influenced by country regulatory factors"* (Manchester: Journal of International Management, 2021), 27.

corruption as an institutional variable, giving a framework to analyze factors in developing countries, starting from the case of Jordan. "It uses multivariate VAR analysis to address the relationships of FDI with institutional factors, economic factors, population and financial factors"[27].

Since the 80s, Jordan embarked on multiple liberal reforms to attract FDI. That works until the end of 2008, coinciding with the subprime crisis. But according to the GAN Business Anti-Corruption Portal (2017), the big problem for an investor in the country is related to corruption, the high level of bureaucracy, the prevalence of 'red tape, and the vagueness of regulations[28]. Considering that, to the usual economical and financial factors that studies analyze, they add the corruption and rule of law, as institutional variables.

The study focused on analyzing the period from 1980 to 2015 in Jordan. The findings revealed that foreign direct investment (FDI) inflows were influenced by factors such as the rule of law, corruption, and population, while other variables were deemed insignificant. The results indicated that a stronger adherence to the rule of law and lower levels of corruption, as reflected by a higher Corruption Perceptions Index (CPI) score, were associated with increased FDI inflows. Thus, corruption was found to have a significant impact on the influx of FDI into Jordan[29].

[27] Hamad A. Kasasbeh et al., *"Corruption and FDI Inflows: Evidence from a Small Developing Economy"* (Jordan: Asian Economic and Financial Review, 2018), 1075.
[28] Hamad A. Kasasbeh et al., *"Corruption and FDI Inflows: Evidence from a Small Developing Economy"* (Jordan: Asian Economic and Financial Review, 2018), 1077.
[29] Hamad A. Kasasbeh et al., *"Corruption and FDI Inflows: Evidence from a Small Developing Economy"* (Jordan: Asian Economic and Financial Review, 2018), 1082.

III. Argument

Multiple political, judicial, labor, social, or macroeconomic factors influence investment decisions. For example, the government regime, political stability, and regulatory complexity, among others, are very relevant factors when deciding to invest in a country or not, especially in time and capital-intensive projects, such as infrastructure projects, energy, or natural resources. Legal certainty and the robustness of property rights are also very important aspects to consider, especially in emerging countries where there are many precedents for expropriations or nationalizations in troubled political periods. Finally, labor legislation and the human capital present in the countries are essential today, where new technologies and work dynamics are important aspects that multinational companies seek to invest in. The thesis will aim to analyze the effects of these independent variables on the dependent variable FDI.

My thesis begins by refuting the assumption that only liberal policies have driven the attraction of foreign investment in Latin America. These reforms that were carried out during the 80s, 90s, and early 2000s are, according to the article by Eduardo Lora, analyzed during the first part of this work, the central reason for the entry of foreign capital into the countries of the region.

From my perspective and basing my analysis on the same results shown in Lora's paper, there were different realities regarding FDI in the region (Latin America), where there were countries that were very liberal when it came to implementing public policies, and very unsuccessful in attracting investors, as well as countries that were more protectionist in their reforms, and had great attraction of capital flows. This could be explained by a greater relevance

of other institutional aspects, different from the liberal or not of the economic and political system of each country. This dilemma will be the one that I will try to elucidate during this work.

IV. Empirical Analysis

a) Definition

The analysis that we do is for nineteen Latin American countries, part of the group that Eduardo Lora used for his analysis. We tried to take all the countries, but the data is not entirely available. Taking this, the aim is to see the effect of the fluctuation of the independent variables on the FDI during two periods, 1990-2009 and 1996-2009. We can't start the evaluation in 1985, the year used by Lora to analyze their index, because some independent variables don't exist before 1990 and 1996. For that reason, we take two different periods, with some additional variables each. Also, regardless of the analysis in the 1990-2009 period having a smaller number of variables, we decided to make it because most of the reforms were made during the last part of the 1980s and the first years of the 1990s.

Additionally, and because the reaction of some independent variables on the dependent variable is not equal, on each of these periods of the independent variables we analyze the reaction on the FDI in t=0, t=1, t=2, and t=3, remaining the independent fixed in t=0. So, in the period 1990-2009, we analyze four scenarios: the reaction to the FDI/GDP during the years of 1990-2009, 1991-2010, 1992-2011, and 1993-2012, but taking the independent variables in the original period of 1990-2009. In this way, when we take the dependent variable in the period 1991-2010 for example, we are considering independent variables in

the period 1990-2009, it means the dependent variables with the effect of independent variable of one previous year.

Next, to judge what Eduardo Lora has stated regarding the importance of liberal economic policies in attracting FDI in Latin America, we will consider his Structural Reform Index, which includes five main policy reforms: trade policy, financial policy, tax policy, privatization level, and labor regulation. Then, to measure the effect of his index and other independent variables on our dependent variables, we will group them into subgroups, which we will incorporate one by one in the econometric analysis, seeing the effect of adding them on the fluctuations in the FDI.

For the analysis about the relation between the independent variables and the Structural Reform Index with the FDI, we will conduct an Ordinary Least Square Regression (OLS), in specific a Multi Linear Regression (MLS). The MLS is the type of regression that will allow us to see the significance of the different independent variables on the FDI. Consequently, the OLS analysis will try to judge the hypothesis that we define to prove our thesis:

$$H_0 = economic\ liberal\ reforms\ are\ the\ main\ driver\ to\ boost\ FDI\ growth$$

$$H_1 = exist\ multiples\ non-economic\ varibles\ which\ are\ relevant\ for\ FDI\ growth$$

Since we will see the effect of certain variables on the same group of countries over time, it is a longitudinal study. In this study, we will see the effect of the percentage changes from one year to another in the independent variables on the dependent variable, foreign investment. In this way we will determine if the variables are statistically significant at 1%,

5%, or 10%, or if they are not. By this way, we will demonstrate if the economic liberal reforms or policies are the main driver to attract FDI or not.

b) Variable Definition

i. Dependent Variable

The dependent variable will be the FDI, but we will evaluate by:

$$\text{Rate of FDI/GDP by year (\%): } \frac{FDI}{GDP_t}$$

The regression will evaluate the variables that affect FDI as a percentage of GDP. The objective is to see a comparable way to evaluate FDI between countries since there could be very large growth in investment due to specific circumstances and not changes in structural aspects. For example, in some cases where the investment rate in the country was very low and suddenly a significant flow of capital entered (it happened during 2022 in Guyana due to its entry into the oil market). The FDI and the GDP data are obtained from the World Bank Data.

ii. Independent Variables

To define the independent variables, we start summarizing the bibliography review in the previous part, to understand why we are choosing our variables:

Text	Author	Analysis
1. American industry in Europe	F.A. Southard	List of variables of the theory of FDI: cost factors, supplement to home activities, servicing, expansion, and nationalism

2. Structural reform in Latin America	Eduardo Lora	A Structural Reform Index, based on: trade policy, financial policy, tax policy, privatizations, and labor legislation
3. Factors that affect Foreign Direct Investment	Jose Ortiz Adame	Define internal and external variables: some are economic freedom, taxes, exchange rate, political reforms, legal certainty, property rights, technological advantages
4. Foreign Direct Investment Determinants in OECD and Developing Countries	Fotini Economou, Christis Hassapis, Nikolaos Philippas, and Mike Tsionas	Use a mix of traditional index and some new ones: regulatory quality, corruption control, economic sentiment, and investment climate indicator
5. Relationship between Institutional Factors and FDI Flows in Developing Countries	Zühal Kurul and A.Yasemin Yalta	They use World Bank Worldwide Governance Indicators: control of corruption, government effectiveness, political stability and absence of violence, regulatory quality, rule of law, and voice and accountability
6. Factors Influencing Foreign Direct Investment in BRICS Nations	Narayanamurthy Vijayakumar, Perumal Sridharan, and Kode Chandra Sekhara Rao	Seven key variables: market size, economic stability and growth prospects, labor costs, infrastructure availability, trade openness, currency valuation, and gross capital formation
7. How FDI inflows to emerging markets are influenced by country regulatory factors	Farok J. Contractor, N. Nuruzzaman, Ramesh Dangol, and S. Raghunath	Eight sub-indicators using a framework developed by the World Bank: starting business regulations, registering property, getting credit, protection of minority investment, tax regulations, trade across borders,

		contract enforcement, and resolving insolvency
8. Corruption and FDI Inflows: Evidence from a Small Developing Economy	Hamad A. Kasasbeh, Metri F. Mdanat, and Raed Khasawneh	Relationship between FDI and corruption as an institutional variable: rule of law, corruption, and population.

Considering the variables reviewed in the bibliographic analysis, I have separated the independent variables into subgroups, trying to consider the ones that show more significance in different studies. Also, we will start our analysis with Eduardo Lora's index, which was created based on the policies promoted by the Washington Consensus, with a focus on liberal economy aspects. This index was developed by the author in a specific period, so we will match our new variables and data with that period to make possible the comparison.

The subgroups will be Structural Reform Index, Economic Variables, Demography, Democracy, Legal Certainty, and Human Capital. Each of these "subgroup variable" have some variables inside, to cover all the aspects. Information from the UN, IDB, and World Bank, various indicators of democracy, human development, and regulatory complexity, are used for our study.

1. **Base Variable for the study:**

   Structural Reform Index: index was created by Eduardo Lora, based on the different reforms that had been done in Latin America since the mid 80s. The index fluctuates between 0 and 1 and is cumulative. For this reason, we will use the growth rate of the index year by year, to see the effect on FDI. The index is composed of five dimensions:

   - **Trade Policy:** consider average tariffs and tariff dispersion.

- **Financial Policy:** combine four indicators: i) indicator of bank reserve ratios, (ii) indicator of freedom of interest rates, iii) taxes on financial transactions, and iv) quality of banking supervision.
- **Tax:** include the top marginal rates of each country. It's just considered the national tax rate, so it could be so distortion in federal countries, like Argentina and Brasil.
- **Privatizations:** index is constructed from the accumulated value of the privatizations, net of nationalizations, as a percentage of GDP.
- **Labor Regulation:** five aspects of the flexibility of legislation are considered in this area: i) ease of hiring, ii) ease of firing, cost of dismissal, iii) flexibility of working hours, extra costs, iv) social security contributions and other taxes and contributions on payroll, and v) minimum wages.

2. **Other Economic Variables (important economic variables that are not considered in the Structural Reform Index):**
    - **Financial Market Development:** World Bank Financial Market Depth, which is the private bank money in private credits. The WBG consider the information of the International Monetary Fund to calculate the money of the banks in private credits to GDP (%).
    - **Inflation:** country annual inflation takes it from the World Bank data.
    - **FX rates:** country currency change value in terms of dollar. Information from World Bank data.

3. **Demography:**

   - **Crime Rate:** homicides every 100,000 habitants, and index created by the World Health Organization. Data is from the database of the organization.
   - **Population Growth:** market size growth rate year by year during the period. We use the information of World Bank Data.
   - **Urban Area Population:** % of the country population that live in urban areas. Data from Our World in Data.

4. **Democracy:**

   - **Democracy Index:** the Electoral Democracy Index by V-Dem, it captures to which extent political leaders are elected under comprehensive voting rights in free and fair elections, and freedoms of association and expression are guaranteed. It ranges from 0 to 1 (most democratic).

5. **Legal Certainty:**

   - **Regulatory Complexity:** Regulatory Quality Index, from the World Bank Data, captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development[30]. Ranging approximately between -2.5 to 2.5.
   - **Rule of Law:** Rule of Law Index, from the World Bank Data, captures the perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property

[30] World Bank Data, https://data.worldbank.org/.

rights, the police, and the courts, as well as the likelihood of crime and violence. Ranging approximately between -2.5 to 2.5.

6. **Human Capital:**

- **Human Development UN Index:** a statistical composite index of life expectancy, education (mean years of schooling completed and expected years of schooling upon entering the education system), and per capita income indicators, used by the United Nations Development Programme to measure country's development. It scores between 0 and 1, and group the countries in tiers, being the ones with an index closer to 1 ranked in the top tier[31].

Dependent Variables Summary		**Source**	**Description**	**Data**
1. Base Variable	a. Structural Reform Index	Eduardo Lora's Study	How reformist was the country during the period	Fluctuate between 0 and 1, cumulative by year
2. Other Economic Variable	b. Financial Market Depth	World Bank Data	Bank money in private credits	Private credits to GDP (%)
	c. Inflation		Annual price growth	Change in prices (%)
	d. Foreign Exchange Rate		Currency versus dollar	Change in currency to dollar (%)
3. Demography	e. Crime Rate	World Bank Data	Homicides per 100,000 habitants	Number between 0 and 100,000
	f. Population Growth Rate	World Health Org.	Population growth rate per year	Change in population (%)

[31] Our World in Data, https://ourworldindata.org/.

	g. Urban Population	Our World in Data	Urban Population Share	Share of total population (%)
4. Democracy	h. Democracy Index	V-Dem Electoral Democracy	Freedom in elections and association	Fluctuate between 0 and 1 (most democratic)
5. Legal Certainty	i. Regulatory Quality Index	World Bank Data	Perceptions of good policy formulation for private sector	Ranging from approximately -2.5 to 2.5
	j. Rule of Law		Confidence in the quality of contract enforcement	Ranging from approximately -2.5 to 2.5
6. Human Capital	k. Human Dev. Index	United Nations	Ctatistical composite index of life expectancy, education, and per capita income indicators	It scores between 0 and 1, group in tiers, being 1 the top tier.

c) Analysis Proposed

So, as we explained in the first section, we want to analyze through an OLS analysis the impact of different variables in the FDI, starting with the thesis that liberal reforms are not the only and main driver for attracting foreign capital.

The regressions that we are going to run and see the value of the β_{it} of the independent variables are:

For 1990 – 2009:

$$FDI_{it} = \alpha_i + \beta_1 SRI_{it} + \beta_2 FMD_{it} + \beta_3 I_{it} + \beta_4 FX_{it} + \beta_5 CR_{it} + \beta_6 PG_{it} + \beta_7 UPG_{it} + \beta_8 D_{it} + \beta_9 HD_{it} + e_{it}$$

For 1996 – 2009:

$$FDI_{it} = \alpha_i + \beta_1 SRI_{it} + \beta_2 FMD_{it} + \beta_3 I_{it} + \beta_4 FX_{it} + \beta_5 CR_{it} + \beta_6 PG_{it} + \beta_7 UPG_{it} + \beta_8 D_{it} + \beta_9 RL_{it} + \beta_{10} RQ_{it} + \beta_{11} HD_{it} + e_{it}$$

$i = 1,2,3 \dots N$ (countries), $t = 1,2,3 \dots T$ (years)

$FDI =$ FDI/GDP ratio
$SRI =$ Structural Reform Index (Eduardo Lora)
$FMD =$ Financial Market Development
$I =$ Inflation
$FX =$ Exchange Rate
$CR =$ Crime Rate
$PG =$ Population Growth Rate
$UPG =$ Urban Population Share
$D =$ Democracy Index
$RL =$ Rule of Law Index
$RQ =$ Regulatory Quality Index
$HD =$ Human Development Index

As we explain previously, in both periods we repeat the regression also for the dependent variable in FDI_{it+1}, FDI_{it+2}, and FDI_{it+3}, but keeping independent variables in FDI_{it}.

d) Empirical Results

For the period 1990 – 2009:

1990 – 2009	Dependent Variable			
Independent Variable	FDI 1990	FDI 1991	FDI 1992	FDI 1993
Structural Reform Index	0.057***	0.046**	0.035	0.024
Financial Market Dev.	0.038****	0.035****	0.033*	0.035***
Inflation	0.000	0.001	0.001***	0.001
Foreign Exchange Rate	0.000	-0.002	-0.001	-0.001
Crime Rate	0.000	0.000	0.000	0.000
Population Growth Rate	-0.785****	-0.786****	-0.714***	-0.636***
Urban Pop. Growth Rate	-0.056****	-0.050****	-0.043***	-0.029*
Democracy Index	0.025**	0.034***	0.040****	0.040****
Human Dev. Index	0.049	0.015	-0.004	-0.030
N° of Observations	380	380	380	380

Significance code:
'****' = 0.001
'***' = 0.01
'**' = 0.05
'*' = 0.1

For the period 1996 – 2009:

1996 – 2009	Dependent Variable			
Independent Variable	FDI 1996	FDI 1997	FDI 1998	FDI 1999
Structural Reform Index	0.022	0.011	-0.001	-0.002
Financial Market Dev.	0.044***	0.033**	0.029***	0.020
Inflation	0.006	0.012	0.005	0.003
Exchange Rate	0.005	-0.004	-0.003	-0.006
Crime Rate	0.000	0.000	0.000	0.000
Population Growth Rate	-0.427	-0.488	-0.433	-0.362
Urban Pop. Growth Rate	-0.052***	-0.042**	-0.03136*	-0.008
Democracy Index	-0.024	-0.024	-0.027	-0.025
Rule of Law Index	0.017	0.027****	0.036****	0.045****
Regulatory Qual. Index	0.003	-0.006	-0.013**	-0.018***
Human Dev. Index	0.035	-0.018	-0.048	-0.100**
N° of Observations	266	266	266	266

Significance code:
'****' = 0.001
'***' = 0.01
'**' = 0.05
'*' = 0.1

The analysis in both periods is quite revealing in some aspects. The first conclusion is that the STR of Lora is only statistically significant in the first years of the period 1990-2009. In the period 1996-2009, it seems not to be relevant, perhaps because the main reforms occurred in the late 1980s and early 1990s, as we said before, so it made sense to analyze for two periods.

The second is the relevance of economic variables. For example, the first thing that can be observed is that the exchange rate and inflation do not seem to be statistically relevant variables in the FDI. Not so the FMD, which measures the depth of the financial market, which is statistically significant in both periods and the short and medium term. This makes a lot of sense since the leverage capacity of the market and the fact that multiple actors could be institutional investors, such as pension funds or insurance companies, is something

very relevant for foreign investors, especially in infrastructure projects, energy, and real estate.

The third result that draws attention is the relevance of demographic variables. Population Growth Rate is very significant in the first period but in the shortest one, something to review because it shouldn't have a relation with the Certainty Index, included in the second period analyzed. Also, is curious about the performance of the Urban Population Index, because the effect seems to be the opposite of what one would think, where the FDI would be higher as the urban population is larger. It may also be that there are diminishing returns in the FDI/GDP ratio as GDP gets higher, something that usually happens when urban areas grow. Finally, the Crime Rate does not seem to be relevant the, which is not statistically significant in any of the periods.

Perhaps one of the most relevant findings for our study is the relevance of legal certainty variables in the long term. We can see that in the period 1996-2009, where these variables, Rule of Law and Regulatory Complexity, are considered, they become increasingly relevant as the years go by. That is, when there is a change in these variables after 2-3 years an effect can be observed. This makes a lot of sense since large investments in assets such as infrastructure or others take time to begin to develop, so the effect on the inflow of capital takes time from when the project is proposed. For the same reason, when something happens with legal certainty, the effect can be perceived in new projects, whose development does not occur before 3-4 years.

Finally, the effect on the democracy variable seems very relevant for the period 1990-2009 but not in 1996-2009. This probably occurs because it may also be implicit in the Rule

of Law variable, which measures similar aspects and behaves very similarly than Democracy in the first period. It also has a relevant effect in the second period analyzed, the Human Development Index variable. This manifests itself in the FDI after a few years, which makes sense since the effect on things like education (such as web developers) doesn't immediately become attractive.

e) MLS Analysis Concerns

Regardless of whether the results make sense to our thesis, there are certain difficulties in the econometric analysis that prevent us from being able to obtain the full effect of certain variables. These problems can be grouped into two aspects: variables and data.

Analyzing the first group, there is a crossover between certain variables that does not allow us to fully see its effect on the FDI. This occurs since some of these variables are constructed and are not an indicator that is obtained "naturally", such as inflation, exchange rate, or demographic variables. For the same reason, when we talk about the Democracy and Rule of Law indicators, certain components determine these variables, and they are probably repeated between the two. In this way, we were able to see how the Democracy effect is affected between the first (1990-2009) and second (1996-2009) periods, which is possibly explained by what was described above.

Continuing with the problem of the variables, there also seems to be some causality between some of them, which means that the effect of all of them cannot be observed in the same period, since some contain the effect of others. For example, in the case of Inflation, this is a driver of the Exchange Rate and the level of Financial Market Development (private debt in banks to GDP). The same could be believed with the Rule of Law and Regulatory

Quality since countries, where regulation is simpler and more effective, tend to be nations with greater compliance with the rules.

On the data side, there could be problems with the quality and timing of the information. Considering that the Structural Reform Index (SRI) has been formulated since 1985, many of the variables that we are considering do not have fully systematized information for technological or transparency reasons in the countries themselves. For this same reason, a problem of temporality is generated, since the information of the independent variables considered is more recent, versus the fact that the reforms considered by the SRI were more intense in the late 80s and early 90s. Given this, I would think that there is probably an underweighting of the effect of the reforms on the FDI in the analysis.

V. Different countries, continents, and policies, but similar results

Already done the statistical analysis of FDI variables carried out in the previous section, we will review different cases of countries that have been successful in attracting investment, but with political and economic reforms and development models with different ideological characters. We consider Latin American countries and others from the rest of the World, intending to extrapolate our analysis and see if the results are something particular to the region or generalized worldwide.

The different strategies presented in this section, show that there is a multitude of factors that can make a country attractive to investors, remarking that legal certainty and stability in the rules are fundamental conditions to allocate resources in the mid and long term in any region.

During the 1980s, Chile implemented several liberal political, economic, and social reforms, intending to boost the opening of the country to the world economy through a model based on the principle of subsidiarity, with less State participation and greater action by civil society in the provision of public goods. These reforms, often referred to as the "Chilean economic miracle," drove an important increase in the FDI during the 80s, 90s, and first decade of the 2000s.

The reforms had different dimensions, all of them with the free-market approach to liberalize its economy. The “free-trade” involved reducing trade barriers, removing price controls, and promoting competition. The government pursued market-oriented policies and reduced state intervention in the economy, creating a business-friendly environment for FDI.

These reforms came together with an aggressive plan of signed free trade agreements with several countries, including the United States, and European and Asian nations, and became a member of the General Agreement on Tariffs and Trade (GATT), which later transformed into the World Trade Organization (WTO). These trade agreements opened up access to international markets and facilitated increased trade and investment flows.

In terms of taxes, the reforms were oriented to reduce the tax burden (20% in 1985 to 13.3% in 1990[32]). These reforms included reducing corporate tax rates (close to 15%) and simplifying the tax system. The government also introduced tax incentives and exemptions to encourage investment in specific sectors or regions (tax exemptions associated with the financial market and the transport sector).

Additional to these reforms in liberal reforms, it introduced reforms to streamline regulations and improve the business environment. This included simplifying administrative procedures,

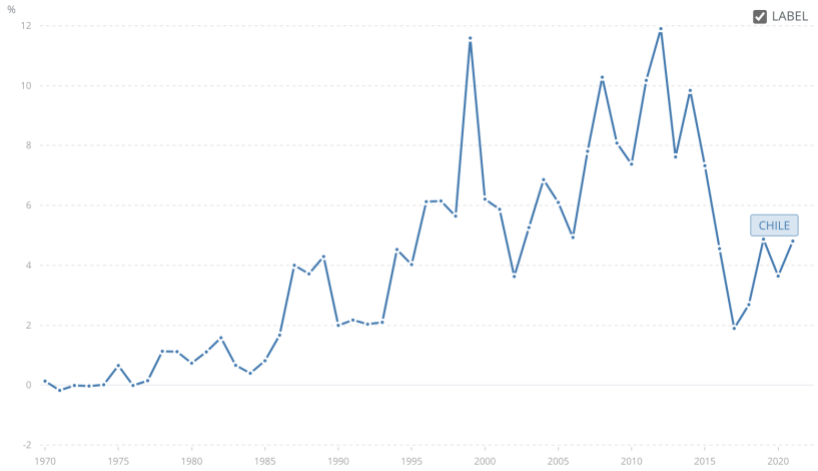
[32] International Monetary Fund Data, https://www.imf.org/en/Data.

reducing bureaucracy, and enhancing legal certainty for investors. The government implemented policies to protect property rights, enforce contracts, and ensure transparency in business transactions.

Finally, and maybe the most controversial reform at this moment, Chile also initiated an extensive privatization program, transferring state-owned enterprises to the private sector. This included the privatization of industries such as telecommunications, mining, energy, and banking through a “popular capitalization”, through which citizens could buy stocks of state companies, thus capitalizing these. Also, some of the public goods commonly given by the state, became in mixed systems, allowing the participation of private players in the market. This occurred in multiple sectors: health, education, water, pensions, and infrastructure.

These reforms, collectively known as the "Chilean economic model" or "neoliberal reforms," resulted in significant results between 1990 and 2020, with a high economic growth that moved the GDP per capita from US$2,480 to US$16,265. The country attracted foreign investment across various sectors, including mining, manufacturing, services, and finance, moving from an FDI of US$661,000 in 1990 to US$9.2 billion in 2020, having years with more than US$30 billion (2012).

Figure 4
Foreign direct investment, net inflows (% of GDP) – Chile



Even though the liberal measures had great responsibility in attracting investment, it was not until before there was greater democratic certainty that the country saw a great response from investors to invest in it. We can see in the Figure 4[33] that regardless the reforms were carried out during the mid-80s, the effects were seen with greater force once Chile returned to having democratic elections, in 1989.

During the 90s, the country managed to mix its pro-market reforms with greater political certainty, a key aspect for new investors, who saw a country with new opportunities in the market for public goods and natural resources, but who had fresh memories of the expropriations at the beginning of the 70s, and the subsequent dictatorship of 17 years.

The transformations in Chile were carried out according to a paradigmatic change in the model of society, where liberal reforms that were implemented to attract foreign capital were also used in multiple areas of society, such as the provision of public goods. However, there are

[33] World Bank Data, https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS.

other countries, with more socialist models or with the Welfare States that guaranteed the provision of "social rights", which managed to be successful through other economic reforms or boosting different important areas (education), but also becoming attractive destinations for investors in multiple factors.

Between the period 2005-2010, Uruguay with socialist president Tabare Vasquez ruling, focus its strategy to attract Foreign Direct Investment (FDI) and improve its business environment through four areas of scope: political stability, business-friendly environment, infrastructure development, and industry focalization.

Uruguay's political stability and democratic governance have been attractive factors for foreign investors. The country has a long history of political stability and respect for the rule of law, creating a favorable environment for investment. This was a big asset during the subprime crisis. Many international funds, especially pension funds, found in Uruguay's land an asset for refuge from the market turbulence[34].

The government also implemented measures to improve the business environment in Uruguay. These reforms included reducing trade barriers, simplifying administrative procedures, reducing bureaucracy, and streamlining regulations to make it easier for foreign investors to establish and operate businesses in the country. Additionally, they established investment promotion agencies, such as Uruguay XXI, to actively attract and facilitate foreign investment. These agencies provided information, support, and assistance to potential investors.

[34] Sebastián Valdomir, *"Inversiones, transnacionales y desarrollo. El caso de Uruguay"* (Montevideo: Friedrich Ebert Stiftung, 2012), 7.

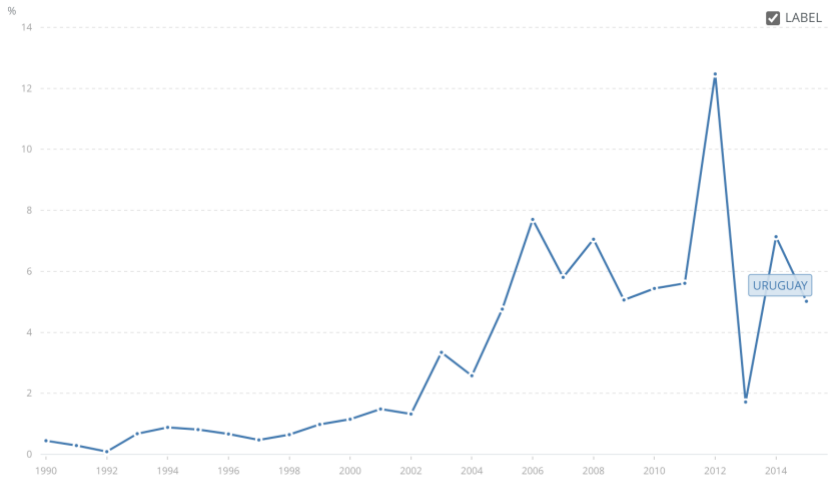
In infrastructure, they focus on its development to enhance its attractiveness to foreign investors. This included improvements in transportation networks, such as ports, airports, and highways, to facilitate trade and logistics. The country also focused on expanding and upgrading its energy infrastructure, including renewable energy projects.

Finally, since 2007 the country oriented its energy policy towards the adoption of renewable sources, early in comparison to other countries. This has brought a large flow of foreign capital, especially in the period 2010-2020. So much so, that between 2017 and 2021, 94% of the energy generated in the country came from renewable sources[35].

These policies generated a strong impact on the attractiveness of investors in the country, causing Uruguay to go from having FDI rates over GDP of less than 15% in the period 1983-2004, to rates above 20% during the years 2005-2012 (Figure 5)[36]. In this way, Uruguay, the country with the smallest population in South America, became the country with the second highest FDI over GDP in the region during the period, only behind Chile[37].

[35] Uruguay XXI, Agency of Investment Promotion. https://www.uruguayxxi.gub.uy/en/.
[36] World Bank Data, https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS.
[37] Sebastián Valdomir, *"Inversiones, transnacionales y desarrollo. El caso de Uruguay"* (Montevideo: Friedrich Ebert Stiftung, 2012), 6.

Figure 5
Foreign Direct Investment, Net Inflows (% of GDP) – Uruguay



Portugal is not typically considered a socialist country, but rather a republic with a mixed economy. However, it implemented after the crisis subprime and in the first half of the 2010-2020 decade, various reforms to attract Foreign Direct Investment (FDI) and improve its business environment. Some of these were more market-oriented, and others try to give more certainty and other opportunities to non-residents of the EU.

Among the “liberal reforms”, Portugal has privatized several state-owned companies and sectors, opening them up to private investment. This includes industries such as energy, telecommunications, and transportation, which have attracted significant foreign investment. Also, they reform the labor market, increased flexibility, simplified administrative procedures for starting and operating businesses, and improved the efficiency of the judicial system. This includes the implementation of an online platform, Empresa na Hora (Company in an Hour), which allows entrepreneurs to incorporate a company within a short timeframe.

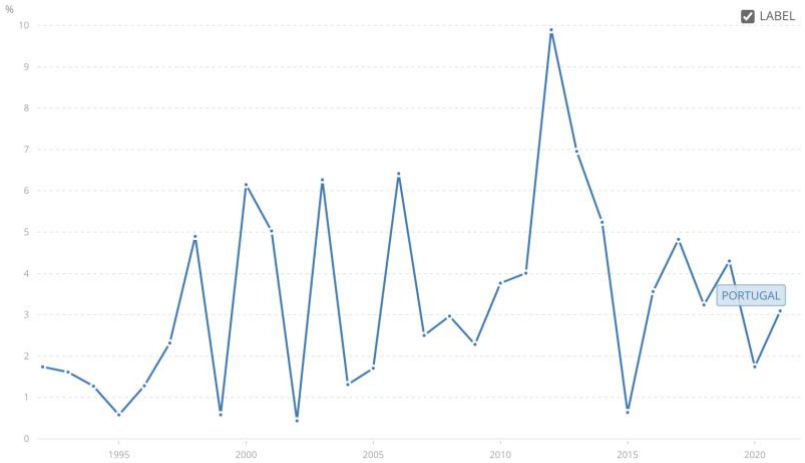
In a mix of liberal reforms but with additional components, Portugal introduced focalized tax incentives, like tax breaks for companies investing in specific regions or sectors, reduced corporate tax rates, and give financial support for certain types of investment projects, like R&D, energy, and agriculture. Also, they give tax exemptions for foreign investors who qualify for the Non-Habitual Resident (NHR) program and created Portugal's Golden Visa program, which allows non-EU/EEA investors to obtain a residency permit in exchange for making a significant investment in the country.

Finally, with the idea of raising human capital, Portugal launched programs to attract talent at the same time. In terms of "The Startup Visa", the program aims to attract foreign entrepreneurs and startups, offering a fast-track process for obtaining residency permits to non-EU entrepreneurs who launch innovative and scalable businesses in the country. The same with the Tech Visa program, attracting international talent to meet the needs of a knowledge-based economy.

Despite not being able to sustain growth in foreign investment for a long time (because it fell into financial default, where it had to be rescued by the International Monetary Fund), between 2007-2012 the country managed to go from a 2.2% to 9.9% of FDI as a percentage of GDP (Figure 6) [38].

[38] World Bank Data, https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS.

Figure 6
Foreign Direct Investment, Net Inflows (% of GDP) - Portugal



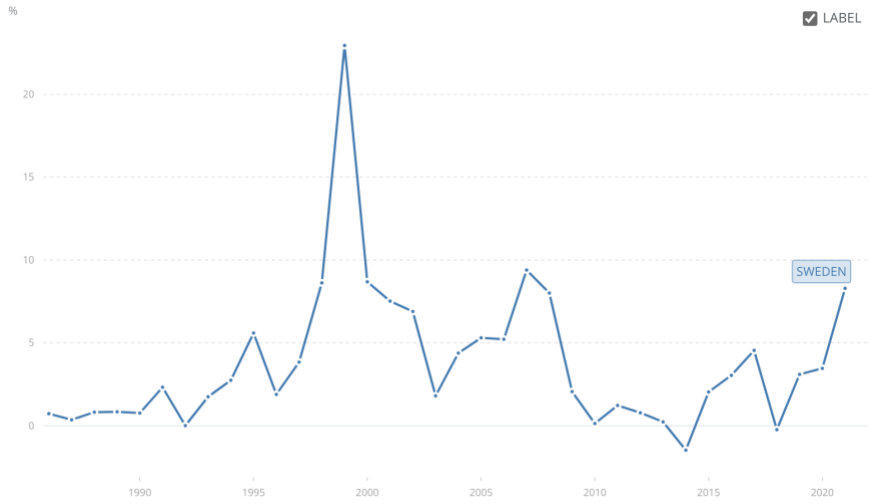
Another good example of a successful attractiveness of FDI, but with a socialist model, is the Nordic countries. Sweden has historically been considered the most successful in attracting Foreign Direct Investment. Focusing on different factors and reforms than the commonly known fundamental for attracting capital, Sweden reached a stable and confident proposal for their investors.

First, and something that was developed over the years, they offer a stable and predictable business environment, characterized by a well-functioning legal system, low corruption levels, and strong protection of property rights. This stability provides confidence and security to foreign investors.

In terms of high-skill workers, the country places great emphasis on education and offers a strong educational system, including universities and technical institutions. Also, to attract talent, they put a strong focus on innovation and research and development (R&D). These technological advancements and scientific expertise attract foreign companies seeking to collaborate and

benefit from the country's innovation ecosystem. Sweden is home to several globally recognized industries, including automotive, telecommunications, pharmaceuticals, and information technology.

Figure 7
Foreign direct investment, net inflows (% of GDP) - Sweden



Even though the Swedish model since the middle of the last century was based on strong state intervention, with high fiscal spending, guaranteed social rights, and a strong relationship with the unions of private companies, the country through a stable democratic system, clear rules, and high human capital managed to become an attractive place for investment, having a very strong growth of the FDI during the second half of the 90s (Figure 7)[39].

Finally, we will see the case of Vietnam, an Asiatic country that has a socialist model, with one party government, led by the Communist Party of Vietnam. Through pro-market reforms

[39] World Bank Data, https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS.

during the late 1980s, the Doi Moi, similar to the ones implemented in China by Den Zhao Ping, the country became one of the most successful Asiatic countries attracting FDI.

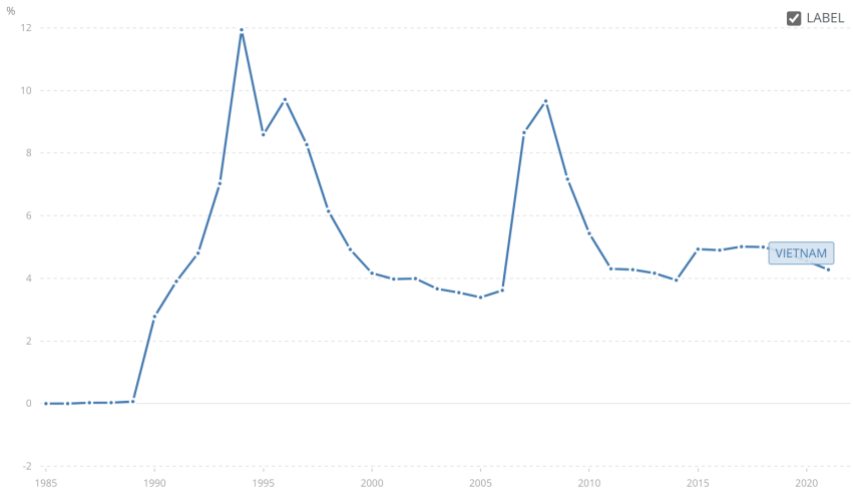
Vietnam implemented a series of economic reforms aimed at transitioning from a centrally planned economy to a socialist-oriented market economy, liberalizing trade and allowing private enterprise. Vietnam has actively pursued and signed numerous bilateral and multilateral trade agreements, like the Association of Southeast Asian Nations (ASEAN) and Asian-Pacific Economic Cooperation (APEC), and trade agreements such as the ASEAN Free Trade Area (AFTA) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

Additionally, Vietnam revised its Investment Law to streamline investment procedures, protect the rights of investors, and enhance the transparency and efficiency of the investment process. They also created Special Economic Zones (SEZs) and Industrial Parks (IPs) throughout the country. These zones and parks offer various incentives and preferential treatments to attract investment, including tax breaks, infrastructure support, simplified administrative procedures, and access to utilities.

Out of economic reforms, Vietnam focuses on other strategies to attract FDI. Their geographical position, in Southeast Asia, offers access to a large consumer market within the region, and proximity to major markets such as China and India. Also, their demographic advantage, with a growing middle class and a relatively low labor cost compared to many other countries in the region, attracted foreign companies seeking a skilled and affordable workforce, developing industries such as manufacturing, electronics, information technology, renewable energy, and tourism. Finally, and associated with its characteristic of a one-party government,

political stability has also been something attractive for foreign capital, without considering the non-democratic factor regarding this political model.

Figure 8
Foreign direct investment, net inflows (% of GDP) - Vietnam



Vietnam, with a different strategy, taking advantage of liberal reforms, strategical geographic position, and young-skill population, became a communist country attractive to investors. The FDI/GDP passed from something close to 0% in the first half of the 1980s, to 12% in 1994 (Figure 8)[40].

[40] World Bank Data, https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS.

VI. Conclusions

Foreign direct investment or FDI, as we call it in large part of the paper, is a very relevant actor in the development of countries. It is the main factor for job creation, economic growth, macroeconomic stabilization, and country development. Given this, it is a widely studied aspect and a much-discussed topic in political economy from different points of view due to the factors that are associated with an increase or decrease in FDI.

In our work, we have tried to participate in this debate by analyzing different variables that, according to the literature, affect the attraction of FDI. We have done this by questioning the assumption that the main factor affecting the attractiveness of FDI is liberal economic policies. Starting from a study carried out by Eduardo Lora, a researcher at the IDB, where affirms that a large part of the attraction of the FDI in Latin America was due to the liberal reforms developed during the 80s and 90s.

Through an econometric analysis, we evaluated the impact of different variables on FDI, to compare them with the Structural Reform Index created by Lora and be able to determine if these liberal policies are the trigger for capital flows or if there are other more relevant aspects. This analysis gave us very interesting results, which do not rule out the fact that liberal economic policies can be very relevant to become an attractive destination for foreign capital, but that this must be accompanied by developed financial markets, legal certainty, and human capital.

In addition to this analysis, we were able to review different international experiences, where there were different public policies developed, with different approaches. Many countries have sought stability and certainty as attractive, others human capital, and some focus on specific industries. In all cases, there has been a mixture of legal certainty, economic incentives, and

variables specific to each country. This also reaffirms our thesis that the success in attracting FDI is due to a multiplicity of factors.

Lastly, and perhaps to settle the issue completely, it remains for a future study to see the relationship between liberal countries and legal certainty. Perhaps there is indeed a strong relationship produced by States with less power over the economy, and therefore Eduardo Lora would be right. But on the other hand, there are countries like Germany or Spain, which, being countries with strong social policies and a large State, manage to have a very successful and attractive public-private mix for foreign capital. For the same reason, any analysis must be done to understand the multifactorial character of the attraction of FDI.

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