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# Review of Economic Freedom Impact on FDI: New Evidence from Fragile and Conflict Countries

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**Abstract**

The present thesis aims at investigating the macroeconomic impact of economic freedom on foreign direct investments inflows in both global and regional panel analysis concerning 156 countries through the periods of 1995-2013. Unlike existing literature, it includes often neglected nations such as Fragile and Conflict-Affected states, Sub-Saharan, Oceania, and Post-Soviet countries. This present study investigates not only the global impact of economic freedom on FDI inflows but also makes regional analysis. The paper finds a positive impact of economic freedom on FDI under fixed-effects model in global case where a unit change in economic freedom scales FDI inflows up to 0.0835 units. More specifically, all 9 regions also refer to positive and significant impact of economic freedom on FDI. The highest impact is recorded in European countries, whereas the lowest ones are documented in Oceania and Fragile-Conflict affected states.


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*Keywords:* Economic Freedom, Openness of Economy, Foreign Direct Investments, Neglected Regions, Panel Data Analysis

## 1. Introduction

The research intends to validate the existing literature on the link between FDI and economic freedom using more current data and large sample size. We study this for nine (9) main regions in order to give a comprehensive comparison. The study also goes beyond by including often neglected, fragile and conflict countries which emerge a gap in the current literature because of lack of data and inconsistencies in data calculation and gathering.

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FDI of Arab countries have negatively been affected by recent instabilities and conflicts, i.e. Arab Spring, this country as well other neglected countries in Oceania, Asia, Latin America and Sub-Sahara are often marginalized and excluded from studies which emerge a gap in literature.

In this study, we attempt to fill this gap by including these fragile-conflict affected states as well as often neglected Post-Soviet. Beside the global analysis of 156 countries through the periods of 1995-2013, the study also gives a sight to the region-based interaction of FDI inflows with economic freedom level of the sample countries.

This study is organized as follow, section one deals with the introduction that indicates the general of the topic underground. The section two deals with the theoretical and empirical approaches of the current literature. In the third section, our focus is on the methods that are used to conduct the research. The section four provides the empirical findings of our research as well the implications of the results. We finally provide a comprehensive conclusion.

## 2. Literature Review

Rapid changes in technologic innovations facilitate access information and easiness of data; provide high speed of data availability. Foreign Direct Investment (FDI) is described as the process through which an individual residing in one country holds an ownership in a company of another country through acquisition, merger, licensing or building of new facility. FDI is however different from other forms of indirect investment such as portfolio investment (bond, stocks, Treasury bills) because it involves more commitment of the investors. In addition, according to OECD, FDI is referred as an investment made by a resident entity in one economy with the purpose of holding a long term interest in an institution located in another country. The ownership referred here should at least be 10% of the voting right which shows the power and authority of the investor. (OECD).

FDI is very crucial for countries because it helps in accumulating capital as source of investment, creates job, increase competition in a country and the biggest of all transfers technology to the host country. FDI is regarded as an engine for growth in the host country and hence has a significant importance.

An extensive empirical literature exists on macroeconomic impact of economic freedom and its components on FDI. For instance, Sambharya and Rasheed [1] (2015) examine the macroeconomic effects of economic and political freedom on FDI inflows in 95 host countries in a panel data analysis through the periods of 1995-2000. Their results suggest before benefiting from FDI inflows, countries need to emphasize on a better economic management in terms sound monetary policy, fiscal burden, and banking and finance. Additionally they advocate that less government participation into an economy, strong property rights, low prevalence of informal markets, and less corruption are desirable for more FDI inflows.

Supplementary, Pearson et al.[2] (2012) investigate the impact of economic freedom and growth on FDI in state levels, indifferent to most studies that consider determinants of FDI inflows into United States as a country. They use a panel data analysis of 50 states through the period of 1984-2007 employing random-effects model. They find that both growth and economic freedom have significant positive impact on FDI in all states. However, the authors also explore that per capita income and unemployment rate cause negative impact on FDI. They address these relations to the fact that states with higher per capita income repel FDI inflows since higher income implies higher wages, and high unemployment rate is positively associated with crime ratio, thus discourages investors' interests.

Likewise Bengoa and Sanchez-Robles [3] (2003) also examine the interplay between economic freedom, growth, and FDI inflows using a panel data analysis of sample of 18 Latin American countries from 1970-1999. They observe that economic freedom remains positive and significant both in fixed- (0.0043) and random-effects (0.0046) regression models deriving similar coefficient magnitudes which imply their robustness. On the other hand, the impact of growth on FDI appears significant only in fixed-effects model with magnitude of 0.01. Eventually, they