

## Political and Economic Determinants of Foreign Direct Investment in G7 Economies

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### Abstract

Economic growth of an economy has contribution from various important factors and one of them is foreign direct investment. The measures of economic growth may be different in one country than other country and from one study to other study. Every country wishes to attract more investment in the form FDI inflow. Inflow of FDI is also affected by many elements/factors available in a particular country. The study analyses the factors responsible for FDI inflow in G7 economies during the period of 1999-2017. For the purpose the data of selected economic indicators was collected from World Bank and selected political indicators from worldwide governance indicators. The data was set in panel data(except for OLS) to run two types of models known as fixed effect and random effect. In the second part, the economic variables are considered as control variables and political variables as random variables.

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### I. Introduction

THE STUDY OF FDI is not a new phenomenon as it was studied since long because of its contribution in the development of economies. Data helpdesk of the World Bank defines Foreign Direct Investment as a “category of cross border investment associated with a resident of a country having control on the management of enterprises in other country”. Economic development of countries has major contribution from Foreign Direct Investment. Foreign Direct Investment helps in development of financial markets, human capital, skill set, new technologies, generate employment,

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R<sup>2</sup> of 47.87%. The second model applied by including political stability as the variable of interest and it was found statistically significant with one more control variable i.e. labour force. The model was fit and R<sup>2</sup> increased to 49.98%. The third model considers the government effectiveness as variable of interest and it was not found to be statistically significant in the model. In the fourth model the variable of interest considered was regulatory quality and the same was not found statistically significant but the constant was found to be statistically significant in this case. Fifth model considered rule of law as variable of interest and it was found statistically significant in the model with constant. The last and sixth model considered control of corruption as the variable of interest and the same was not found to be statistically significant in the model. The Model 4, Model 5 and Model 6 have four statistically significant economic variables out of five and also significant intercept with model fit a good R<sup>2</sup>. To brief about the results politically stability and rule of law are the most significant political variables having impact on inflow of foreign direct investment in G7 economies.

#### VI. Conclusion

The present study aimed at finding the economic and political determinants of foreign direct investment inflow in G7 economies during the period of 1999-2017. The analysis was carried out in three parts. First part is related with the trend analysis of all the variables and it can be seen the FDI inflow in these economies was not stable and have frequent fluctuations during the period of study. The second part deals with panel data analysis and all the variables (economic as well as political) treated as independent variables and 3 models estimated viz. Fixed Effect Model, Random Effect Model and OLS. The results of these three models are mixed and indicate that most of the economic variables are found to be statistical significant and determine the inflow of foreign direct investment in G7 economies during the period of study. In the last and third part of study the economic variables were treated as control variable while political variables were introduced one by one as variables of interest. Total 6 models were run in this part and it was found that only two political variables out of six are statistically significant but most of the economic variables were statistically significant in these models also.

The analysis suggests that economic variables have more impact and determine the inflow of foreign direct investment in G7 economies during the period of study in comparison to political determinants. The study will be helpful in policy formulation to attract more FDI inflow in these economies.

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