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Eirini Triarchi
Corresponding Author

University of Ioannina,
Department of Accounting and Finance,
Ioannina,
Greece
✉ etiarhi@uoi.gr

John Marangos

University of Macedonia,
Department of Balkan, Slavic and Oriental Studies,
Thessaloniki,
Greece
✉ marangosjohn@gmail.com

The Political Determinants of Inward FDI

Summary: The popularity of Foreign Direct Investment (FDI) stimulates research on its determinants. This paper highlights the importance of political determinants in explaining inward FDI variation across countries. Adopting the argument that no single theory exists for FDI, it identifies the political factors based on the results of related empirical studies. The literature review's primary concern is to provide underpinnings for further research on inward FDI distribution in the contemporary international political scene. It sets up the theoretical links between political regimes, political determinants, and FDI. The paper focuses on the importance of specific political variables established in all political systems to influence foreign investors' decision-making process. The distinguished determinants are property rights protection, the signing of Bilateral Investment Treaties (BITs), human rights, and quality of governance.

Keywords: Foreign direct investment, Political determinants, Political regimes, Governance, Property rights, Bilateral investment treaties.

JEL: F21, F23, F53, P14, P16.

The importance of inward FDI to host countries' broad-based economic and social development is well-documented. Beyond the economic determinants that have been widely studied, political determinants are also critical in explaining inward FDI variation. Empirical studies have examined the impact of the host country's political system on FDI based on two opposite types of political regimes: democracy and authoritarianism. Most of the studies have produced contradictory empirical results and provoked serious disagreements among economists regarding the impact of democracy and authoritarianism on FDI. Hence, it is important to establish the state of knowledge given the current distribution of political regimes concerning the specific political factors in the host country's political surroundings in determining the volume of inward FDI flows.

This paper aims to develop the main political determinants and set up the theoretical links between political regimes, political determinants, and FDI by reviewing sixty-two empirical studies. The paper contributes to the literature by distinguishing four key political factors related to FDI inflows, i.e., property rights protection, the signing of Bilateral Investment Treaties (BITs), human rights, and quality of governance. Students and scholars of international economics will benefit from this novel contribution by synthesizing the literature on the political determinants of inward FDI that can serve as a basin in further empirical research and policy formulation.

The paper is structured as follows: Section 1 includes FDI's main definitions and reviews FDI's theories, while Section 2 presents the relationship between inward FDI and the types of political regimes. Section 3 describes political regimes' impact on inward FDI and reviews the 62 empirical studies for political determinants on inward FDI. The final section concludes.

1. A Review of FDI Literature

This section starts with FDI's central concepts, followed by a short review of the main theories of FDI, presenting the complexity of the research in the area. The institutional theoretical framework developed in Subsection 1.2 highlights the importance of political factors to FDI's studies.

1.1 FDI Main Concepts

The definition used in the paper is the official definition of FDI follows the fourth edition of the Organization for Economic Cooperation and Development (OECD) Benchmark Definition of Foreign Direct Investment (OECD 2008, 2015). Specifically, OECD (2015, p. 5) defines FDI as "the establishment of a lasting interest in and a significant degree of influence over the operations of an enterprise in one economy by an investor in another economy. Ownership of 10% or more of the voting power in an enterprise in one economy by an investor in another economy is evidence of such a relationship".

Hence, FDI implies control of foreign firms over the domestic productive capacity. United Nations Conference on Trade and Development (UNCTAD 2017, p. 3) defines the term FDI flows as "flows of FDI comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to an enterprise, or capital received from an investing enterprise by a foreign direct investor". FDI net inflows include those investments that acquire the lasting management interest of 10 per cent or more of voting stock in an enterprise of the host economy (Quan Li and Adam Resnick 2003, p. 188). It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital, as shown in the balance of payments. This measure of FDI represents the amount of FDI that flows into a country, net of divestment in the period (Li 2009a, p. 174).

Inward FDI contributes positively to financing current account deficits based on its non-debt-creating mechanism, especially for those economies that have suffered too long from sizeable current account deficits (Dimitri G. Demekas et al. 2005, p. 3). Its positive impact on the economy is attributed to the transfer of appropriate knowledge, organizational, management and technology transfer (know-how) to domestic firms and local labour force alike, as well as the achievement of production spillovers, enhancement of intra-industry competition, and increasing access for exports abroad, notably in the source country (Demekas et al. 2005, p. 3; Valerija Botrić 2010, p. 10).

However, there is a dispute about the benefits of FDI on the recipients' economies. Although inward FDI boosts competitiveness combined with the kick of total factor productivity of the host country's output and rises in domestic income, it may also provoke inefficiencies. Negative productivity spillovers may emerge through the transfer of know-how to domestic firms and the reduction of domestic investments. There are cases in which MNEs entering the host economy push less efficient domestically owned firms out of the market, negatively influencing domestic investment and productive capacity at least short-term (Kristine Farla, Denis de Crombrugghe, and Bart Verspagen 2016, p. 1). The crowding out is more likely to happen when competitive MNEs are technologically advanced or domestic firms have limited absorptive capacity (Cristina Jude 2019, p. 164).

There is also the issue of whether inward FDI provides R&D activities in the host market. If not, then FDI provokes reductions in employment positions, especially for highly qualified labour, causing brain drain (Leonid Melnyk, Oleksandr Kubatko, and Serhly Pysarenko 2014, p. 19). In addition, foreign firms choose to repatriate their profits when the recipient country has weak institutions. Foreign investors avoid entering a market where property rights are poorly protected and contract enforcement is problematic (Ghalib Bin Faheem and Danish Ahmed Siddiqui 2020, p. 135). When foreign capital flows out from the host economy, they do not complement domestic capital supply and, as such, limits the financing of local investment projects. Therefore, foreign firms that acquire a strong position in the host market may negatively influence growth and investment in the recipient country.

Overall, FDI inflows record both positive and negative effects on host countries' economic growth. However, developing countries, emerging economies, and economies in transition liberalise their investment regulatory framework to attract FDI flows and gain from their positive contribution to economic growth. The prospect of domestic income growth motivates governments to implement FDI-friendly policies, including investment treaties, special taxation schemes and loans.

1.2 FDI Theories

The establishment of a consensus that can thoroughly explain the phenomenon of FDI is inhibited by the many theories developed, including the motivations of firms' engagement in FDI (Pravin Jadhav 2012; Byung Il Park and Taewoo Roh 2019). The first analysis of FDI focused on Multinational Enterprises (MNEs) from leading Western economies investing abroad by exploiting their international leadership and competitive advantages, often in developing economies (Jan Knoerich 2017, p. 52). Early theories incorporated economic and international trade theory to the cross-border movement of capital, following the relatively simple two-country, two-commodities and two-factor approaches and the assumption of perfect markets (Knoerich 2017, p. 53).

The basis for subsequent theoretical development in FDI came through Hymer's analysis in "*The International Operation of National Firms*", which distinguished FDI from portfolio investment in terms of control of operation that is conferred to the firm only through FDI (Peter J. Buckley 2006, pp. 140-141). Hymer related the exercise of control to market imperfections regarding transaction costs, lack of perfect information, and imperfect competition. He stressed the importance of the ownership of a monopolistic advantage as a prerequisite for an MNE to enter a foreign country. Hymer developed a theory of FDI outside the neoclassical international theories of trade and finance and into the industrial organization, the study of market imperfections (Hamid Hosseini 2005, p. 532). This approach also became known as the Hymer-Kindleberger paradigm since Kindleberger places Hymer's conceptualization within the framework of the traditional theory of industrial organisation (Hosseini 2005, p. 532).

The internalization theory, based on a pioneering paper by Coase in 1937, only gained recognition for explaining FDI in the 1970s and 1980s through the works of distinguished economists such as Oliver Williamson, John McManus, Peter J. Buckley and Marc Casson, John H. Dunning, Jean Francois Hennart, and Alan Rugman. Internalization is linked to imperfections in the markets for intermediate products that embrace all the different types of goods or services transferred between one activity and another within the production process. Firms expand across borders because internalising these markets can reduce the transaction costs incurred in international intermediate products. Hence, internalization's association with transaction costs is evident, as well as its ability to explain vertical and horizontal integration across borders (Geoffrey Jones 1996, p. 12). The internalization theory faced criticism for being more of a theory of market failure rather than of firm success and being overconcerned with the costs of organising transactions in markets, ignoring the managerial costs incurred by firms.

Dunning brought together internalization theory and traditional trade economics to establish the eclectic paradigm of FDI, synthesizing the reasons for enterprises to operate internationally (advantages) and the mode of entry (FDI, export and licensing) (Isabel Faeth 2009, p. 171). The OLI paradigm is neither intended to be a theory of the MNE nor the FDI per se (Chris Wagner 2020, p. 58). Dunning developed the eclectic or OLI paradigm in a series of publications during the 1980s and 1990s. Dunning's paradigm distinguished among the other attempts to model the empirically observable determinants of FDI.

"OLI" denotes ownership, location, and internalization, as the enterprise's advantages that may spark its decision to become a multinational. Among the theories produced, the OLI paradigm is considered the most developed conventional perspective of FDI, providing a valuable way of thinking about MNEs. It encouraged a great deal of applied work in economics and international business and enjoyed popularity, especially among British, Commonwealth and European scholars (Knoerich 2019; Park and Roh 2019).

The OLI paradigm equally applies to an analysis of either outward or inward FDI, with O-advantages reflecting the outward FDI while L-advantages the inward FDI (John Cantwell 2015, p. 4). Ownership (O) advantages refer to the MNE's production process, ensuring a competitive advantage over domestic firms. The O-specific advantages include ownership of assets (Oa) and the economies of common governance (Ot). The Oa refers to various tangible and intangible assets the firm owns, whether this is intellectual property rights like patents and trademarks or stocks of tacit knowledge or tangible superior technology, property and equipment (Sarianna M. Lundan 2009, pp. 54-55). The ownership of intangible assets diversifies the firm across borders allowing it to exploit economies of scale and gain monopoly power (Li and Resnick 2003, p. 179). The Oa advantages align with the resource-based view that a firm can hold its competitive position if its assets are valuable, rare, and difficult to imitate or substitute (Lundan 2009, pp. 55-56). The Ot refers to strengths in coordinating and taking advantage of operating a network of geographically dispersed affiliates (Alan M. Rugman, Alain Verbeke, and Quyen T. K. Ngugen 2011, p. 761).

Dunning's paradigm developed and adapted to the changes in scholarly interest that arose when substantial shifts in the international business field occurred, like globalization and MNEs from emerging economies (EMNEs). In a revised paradigm version, Dunning incorporated the importance of institutions in O-advantages (John H. Dunning and Lundan 2008b). To this extent, the Ownership institutional advantages (Oi) represent the formal and informal institutions that enable firms and their international business networks to create and retain trust and legitimacy in the broader political and social environment (Cantwell 2015, p. 13). Hence, Oi includes the institutions that govern the value-added processes within the firm and between the firm and its stakeholders and are partly endogenous and exogenous in the firm (John H. Dunning and Lundan 2010; Lundan 2009). Dunning and Lundan (2010, p. 1230) argue that "The exogenous element results from the degree to which the informal (and formal) institutions in the firm's home country, or important host countries, have impacted the way in which incentives are set within the firm. The endogenous influence results from the entrepreneurial or managerial activity, which manifests in a particular corporate culture, which may also be encapsulated in the firm's core values or a mission statement". Substantial Oi advantages may be required for the firm to be able to exploit its existing Oa and Ot advantages (Lundan 2009, p. 60).

The location (L) advantages are associated with foreign countries having some country-specific advantages (CSAs) over other countries (Rugman, Verbeke, and Nguyen 2011, p. 761). In particular, L-advantages are motives for producing abroad, including access to capital, access to actual endowments such as richness of natural resources and skilled and low-cost labour force, control over transfer price, reduction in exchange risks, and lead and lag payments. The L-advantages remain attractive for an MNE as long as transactional gains from operating in different locations exist (Said Elfakani and Wayne Mackie 2015, p. 101). The L-advantages include elements of the cultural, political, and broad institutional environment in which the enterprise operates, making some countries more attractive than others. Dunning indicates the host country's market structure and government policies as potential L-advantages (Rugman, Verbeke, and Nguyen 2011, p. 761). The revised paradigm version presents the new classification of L-advantages (Dunning and Lundan 2008b). Thus, the resource- and asset-related L advantages (Lr), such as access to natural and human resources or critical (knowledge-intensive) assets, and institution-related L-advantages (Li), refer to a host location's formal and informal institutions (Wagner 2020, p. 69). Dunning (2008, p. 94), adjusting his paradigm in the changing world, identified globalization, technology, and new players' emergence to increase the significance of institutions and institutional distance as location-specific determinants.

OLI's paradigm as a synthesizing framework indicates the key location advantages of four types of international production: natural resource-seeking, market-seeking, efficiency-seeking and strategic asset-seeking (Rugman, Verbeke, and Nguyen 2011, p. 761). Although the O- and L-advantages justify why enterprises will move production to a foreign location, they do not explain why an enterprise does not license a foreign firm to produce the product for the patent firm (Nathan M. Jensen 2003, p. 591). The internalization (I) advantages affect how an MNE chooses to operate in a foreign country, trading off the reduction in the cost of transactions and the holding-up costs of its wholly-owned subsidiary (Park and Roh 2019, p. 72). The more significant the I-advantages, the more likely a firm is to engage in international production instead of trading or leasing. Antitrust or competition-oriented regulation can affect firms' exploitation of I-advantages (Li and Resnick 2003, p. 179). Regarding the third element, Dunning's eclectic paradigm and the internalization paradigm of Rugman, Buckley and Casson are similar (Hosseini 2005, p. 533). In the revised OLI version, Dunning and Lundan (2008a, p. 587) highlighted the institutional character of the I-factor in terms of the transaction costs related to FDI activities that an efficient institutional environment can reduce or, in the opposite case of inefficiency, can increase.

As the share of FDI from emerging economies in global FDI flows increases, there is a remarkable intensification of FDI theorization to explain EMNEs' expansion. Compared to traditional MNEs, the EMNEs do not base their growth on strong firm-specific advantages (FSAs) since they lack international experience, are less competitive, and are smaller (Knoerich 2019, p. 52). Knoerich (2019) proposes a re-orientation of FDI theory to explain FDI flows from EMNEs'. Thus, better to focus on the "demand-oriented approach" than on firm-specific advantages (FSAs). This approach does not support that FSAs are a requirement for a firm to engage in FDI but considers the firm as an entity aiming to satisfy its demand for advantages, assets, and resources abroad. Hence, EMNEs venture abroad to access otherwise unavailable resources and thereby establish a global position for themselves (John A. Mathews 2006, p. 17). Knoerich (2019, p. 63) argues that a demand-oriented perspective promotes a holistic view that includes all kinds of FDI by all kinds of firms.

Finally, Aristidis P. Bitzenis (2003) pointed out that no theory is dominant in the decision-making process of MNEs regarding FDI and, on this basis, created a theoretical model named "The Universal Model". This broad model incorporates the most dominant FDI theories and is subject to change since some theories have become obsolete and the world economy has evolved (Bitzenis and Pyrros D. Papadimitriou 2011, p. 352). Some of the FDI theories are static, including only the factors that lead to the decision of FDI and other dynamics, considering the evolution of the foreign enterprise and its interaction with a host industry and host country (Bitzenis 2003; Bitzenis and Papadimitriou 2011; Bitzenis, Papadimitriou, and Vasileios A. Vlachos 2012). The Universal Model is less eclectic and more encompassing than Dunning's paradigm and defines the FDI's motives regarding their content (Vlachos et al. 2019, p. 270). The model connects all the FDI theories on the basis that the firm's ultimate purpose is to ensure its profits. To this framework, the categorization of motives is as market seekers, market seekers from a strategic point of view, factor seekers, efficiency seekers, locational seekers, exploiting ownership advantages, financial aspects hunters, political reasons and overcoming imperfections (Bitzenis 2003; Bitzenis and Papadimitriou 2011; Bitzenis, Papadimitriou, and Vlachos 2012). The universal model uses the above branches depending on the firm's profile and priorities. Its main benefit is that it presents both the effects that a potential FDI project may have on a firm and its potential gains from this project (Bitzenis, Papadimitriou, and Vlachos 2012, p. 51).

In sum, theories in FDI are adjusting to the advances in the international business environment. FDI cannot be explained by a single theory but rather by combining theoretical models that complement each other.

1.2.1 Institutions in FDI Literature

In his eclectic paradigm, Dunning incorporated many non-economic variables, highlighting the importance of political and legal influences on ownership, location, and internalization factors (Jones 1996, p. 13). Jensen (2003), Li and Resnick (2003) and Robert G. Blanton and Shannon L. Blanton (2007) adopted the eclectic paradigm's approach to their research of the impact of political institutions on FDI. A firm decides on investment sites based on how effectively their O- and L-advantages harmonize with L-specific benefits. Host government policies establish L-specific conditions, affecting how a firm can exploit its advantages (Li and Resnick 2003, p. 180). The O-advantages are sensitive to property rights protection in the host country (Li and Resnick 2003). A host country creates a good investment climate when its L-specific advantages enable the MNE to exploit its O- and I-advantages. A host government that provides favourable regulation, sound property rights protection, and foreign enterprises' preference over domestic firms makes the country attractive to FDI. A host government can enhance O-advantages through the proper regulatory environment by helping MNE preserve their intangible aspects or monopolistic advantage over local firms (Blanton and Blanton 2007, p. 145). The host state, as it is responsible for providing preferential taxation policies, financial incentives, qualified labour force, and political stability, is crucial in making the country a desirable location for FDI (Blanton and Blanton 2007, p. 145). Along the same line, Jensen (2003, p. 592) argues that political regimes that reduce the political risks will attract MNEs by lowering the costs of internalizing production.

Research on emerging economies in the 2000s acknowledged the importance of institutions in FDI, and this motivated Dunning to revise the eclectic paradigm (as presented in Subsection 1.1) by incorporating the institutional-based view (Dunning and Lundan 2008b). Institutions and organizations operate in the over-arching institutional environment, or institutional infrastructure, as Dunning (2004) calls it. Academics in economics, political science, sociology, and other social sciences differentiated their conceptions of the institutional environment and incorporated different relative values in its definition. The definition issue and the subjectivity in the concepts about institutions rise as an important problem in linking the institutions with economic development (Andrés Rodríguez-Pose 2020, p. 373). Ram Mudambi and Pietro Navarra (2002, p. 638) indicate that the institutional environment "includes political institutions such as the regime type, the national structure of policymaking and the judicial system, economic institutions such as the structure of the national factor markets and the terms of access to international factors of production and socio-cultural factors such as informal norms, customs, mores and religions". Institutions are essential since they represent the major immobile factors in a globalized market.

In contrast to firms and factors of production, being sensational mobile in the international environment, the legal, political, and administrative systems are internationally immobile (Mudambi and Navarra 2002, p. 636). An inefficient institutional environment with inadequate property rights, lack of regulated banking system, high corruption, underdeveloped financial markets and weak incentive structures is relatively costly in doing business and inhibits FDI into host economies (Dunning 2004, p. 3).

Mike W. Peng, Denis Y. L. Wang, and Yi Jiang (2008, p. 931) proposed an institution-based view, combined with the industry- and resource-based views, to explain the extent to which firms engage in international business are successful or not. Hence, a foreign investor building strong interpersonal relationships with the host country's authorities (like government officials) feels more secure. Peng (2014, p. 70), taking as an example the MNEs investing in Africa, concludes that MNEs with the best capabilities to manage the institutional conditions in the host market will be the ones performing successfully in such a challenging environment. Regarding the country-level efforts to attract FDI, the host government must prioritize strong building institutions that reduce uncertainty and FDI-related costs for foreign investors (Robert Grosse and Len J. Trevino 2005, p. 140). Kalle Pajunen (2008) distinguished seven institutional factors in his research related to FDI inflows that were conceptualized and received explicit, empirical consideration. These are corruption, labour regulation, justice and judicial system, political rights and civil liberties, property rights and taxation policies.

Bitzenis (2003), in his Universal model, incorporates the importance of institutions by supporting that the risk of investing in their market is high in countries with political or social instability like the transition one. The transition economies that hold significant delays in the transition process record an increase in their economic and political instability, resulting in high investment risk and low inward FDI (Bitzenis and Papadimitriou 2011, p. 364). These delays are caused due to unclear property rights, delays in restitution, low progress in privatization, banking reforms and liberalization, high bureaucracy, corruption, and organized crime.

In sum, Dunning's eclectic paradigm, the institutional approach and Bitzenis' Universal model have incorporated political institutions in FDI research. Dunning included in his model political determinants and revised the model following the advances in institutional theory. Some scholars on the debate on the relationship between political regime and inward FDI embraced the eclectic paradigm and the institutional theory, while others followed the empirical findings of the extant literature. This paper adopts the argument that no single theory exists for FDI (Bitzenis 2003; Jadhav 2012; Park and Roh 2019) and serves its analysis focal point by identifying specific political determinants with a significant impact on FDI based on the review of the reported related empirical studies in Section 3.

2. Inward FDI and Types of Political Regimes

Two types of political regimes dominated the empirical research on the impact of political regimes on FDI, either democracy or authoritarianism (the term autocracy is interchangeably used). However, the political reality records new forms of political regimes rooted either in the concept of democracy or authoritarianism, producing difficulties in distinct classification of countries' political systems. These regimes embed some of the institutions that are necessary but not enough to make a democratic regime and some of the institutions that characterize an authoritarian rule of governance. The adjectives attributed to them are anocracies or hybrid regimes, or democracies with characterizations such as unfinished, stalled, halted, transitional, frozen, weak, and fragile (Jeroen van den Bosch 2013, pp. 81-82).

A democratic political system must have broad-based support and consensus to build an effective and secure political process (Yi Feng 2001, p. 272). For a regime to be considered democratic in modern times, it also must protect the rights of individuals and minorities to guarantee its citizens' freedom or liberty. These guarantees are incorporated into the constitution, and the government is limited and constrained by the rule of law; to this extent, democracy in today's world is often called constitutional or liberal democracy (Marc F. Plattner 2010, p. 84).

The collapse of centrally administered socialism in the Soviet Union and Eastern Europe provoked a remarkable rise in the number of democracies, and since 1995 electoral democracies have become the world's dominant form of regime, enclosing more than 60 per cent of all countries (Plattner 2014, p. 5). Electoral democracies hold de-facto, free and fair, multiparty elections in a pluralistic media and associational environment (Anna Lührmann et al. 2019, p. 15).

Democracy in transition countries was questioned in terms of its consolidation. The reformist governments in the 2000s facilitated the re-emergence of some forms of authoritarianism by failing to leave behind their autocratic past (Florian Bieber 2018, p. 337). The new regime forms are rooted in the concept of authoritarianism identified with adjectives such as "electoral authoritarianism" or "centre authoritarianism with subnational democracy", "semi-authoritarianism" or "competitive authoritarianism" (Matthijs Bogaards 2009, p. 406). Steven Levitsky and Lucan A. Way (2010, p. 5) defined competitive authoritarian regimes as "civilian regimes in which formal democratic institutions exist and are widely viewed as the primary means of gaining power, but in which incumbents' abuse of the state places them at a significant advantage vis-à-vis their opponents. Such regimes are competitive in that opposition parties use democratic institutions to contest seriously for power, but they are not democratic because the playing field is heavily skewed in favour of incumbents. Competition is thus real but unfair". The multiparty competition is what characterizes democratic regimes, but this criterion is quite different in autocracies. Authoritarian multiparty refers to a cluster of regimes on the lower end of the democratic spectrum, which is the opposite of democracies, positioned at the higher end (Michael Wahman, Jan Teorell, and Axel Hadenius 2013, p. 21). Electoral autocracy is the most common type of authoritarianism globally, with a count of 55 countries among 80 countries under the authoritarian rule of governance in 2018 (Lührmann et al. 2019, p. 15).

Some states under political systems in competitive authoritarianism political zone have increased hostility toward advancing democratic rule and establishing institutions under international law that could enforce democracy and human rights. Democracy is threatened globally by governments' manipulation of media, civil society, the rule of law, and elections, followed by the toxic polarization in the public scene that results in the division of society into non-antagonistic camps, and finally the digitalization as being misused by governments to manipulate the information environment in their countries (Lührmann et al. 2019, p. 5). These issues reflect a decline of democracy and a rise of illiberal politics, reported both in consolidated democracies and in democracies with weak institutions (Bieber 2018, p. 339). Nevertheless, democracy remains the most common regime type and holds its advanced legitimacy (Lührmann et al. 2019, pp. 15-16). It satisfies the citizens' need to respect their human rights and secures political freedom and stability.

The democratic regime holds an independent "virtue" of the rise of protest, efficiently managing its solid institutions and preventing destabilizing threats. Democracy can at least institutionalize the redistribution system, support the reduction of income inequality, and restrain the possibility of the low-income class expropriating the wealth of the highest income. It appears to create a more secure business environment for foreigners through its strong institutions that manage efficiently and prevent destabilizing threats. Hence, a host country under democratic governance rule may receive more foreign capital than a non-democratic one. This argument cannot be confirmed due to the intervention of other factors in political systems. Additionally, the zenith of confusion in existing regime classifications and the lack of a systematic way of measuring the new mode of autocratization (Lührmann and Staffan I. Linberg 2019, p. 1097) motivates this research to rely beyond the type of political regime on specific political determinants for the extraction of unambiguous results and not on the political regime itself.

3. Political Regimes, Political Determinants and Inward FDI

This section reviews 62 empirical papers to answer how a host country's political system affects its FDI inflows. The complexities of the dispute and the contradictory empirical results reflect the notable disagreements among political scientists and economists on the impact of the host country's political regime on FDI. Hence, this empirical review incorporates studies that include political variables that significantly impact inward FDI. The identified political determinants are deemed to increase the institutional stability and credibility of the political regime and, as such, foster the country's growth in FDI. After describing the methodological approach used to obtain the sample of the studies, Subsection 3.2.1 presents the relationship between inward FDI and political regimes, while Subsection 3.2.2 synthesises the review's findings on the relationship between the host country's critical political determinants with inward FDI.

3.1 Methodology

Our research focuses on studies published in peer-reviewed English language journals and a few cases in working papers issued by official institutions in subject areas most relevant to the given topic from 1996 to 2019. First, we created our dataset focusing on empirical studies discussing the relationship between political regimes and inward FDI and then adding studies including political determinants. Combinations of the keyword "FDI/foreign direct investment/inward FDI/FDI inflows" with keywords relating to "political regime", "political system", "political institutions", "democracy", and "authoritarianism" are used in several databases, i.e. Scopus, Science Direct, Google Scholar to identify the relevant studies. Then more advanced research using combinations of the keyword FDI as described above with keywords relating to "political determinants", "property rights", "bilateral investment treaties", "human rights", "corruption", "political stability", "rule of law", "governance" to obtain the final sample of the studies. Regarding the quality of articles in the sample, the empirical studies included are published in journals listed either in the ABS academic journal guide (2021), in the Australian Business Dean Council (ABDC 2019), or SCImago Journal Rank Indicator.

The reviewed studies are quantitative, while few articles are supplemented by qualitative research. The type of journals these studies are published indicates that the research on political FDI determinants is cross-disciplinary, situated at the interface between economics/political sciences/social sciences/business management/international business studies.

The empirical studies (please see Table A1 in the Appendix) use different measures of FDI as the dependent variable in their empirical research. The most used is the net FDI inflows as a percentage of GDP (Jensen 2003; Pierre-Guillaume Méon and Khalid Sekkat 2005; Blanton and Blanton 2006, 2007, 2009; Tim Büthe and Helen V. Milner 2008; Seung-Whan Choi and Yiagadeesen Samy 2008; Fathi A. Ali, Nobert Fiess, and Ronald MacDonald 2010; Glen Biglaiser and Joseph L.Staats 2010; Elizabeth Asiedu and Donald Lien 2011; Peter B. Rosendorff and Kongjoo Shin 2012; Staats and Biglaiser 2012; Luisa Melo and Michael A. Quinn 2015; Ida Bastiaens 2016; Rodríguez-Pose and Gilles Cols 2017) and the natural log of net FDI inflows (Jeswald W. Salacuse and Nicholas P. Sullivan 2005; Jo Jakobsen and Indra de Soysa 2006; Alemu Aye Mengistu and Bishnu Kumar Adhikary 2011; Blanton and Blanton 2012; Cem Tintin 2013; Chungshik Moon 2015; Moshfique Uddin et al. 2019). Some scholars use the logarithm measure to reduce the effects of outliers, avoiding using a proportional index to measure FDI. It is argued that the logarithm will lead to more precise results about the impact of political regime on the amount of inward FDI (that is, using FDI as a percentage of GDP as the key-dependent variable) (Li 2009a; Blanton and Blanton 2012; Mark David Nieman and Cameron G. Thies 2019).

The variable for measuring the regime type varies across the literature, along with the indices commonly used to measure the quality of democracy (some of the most used are the Freedom House rating, Polity IV, The Political Constraint Index (POLCON), International Country Risk Guide and Varieties of Democracy). The indices used for the political determinants are also found in the above indices and UNCTAD database (i.e., International Investment Agreements Navigator for Bilateral Investment Treaties). However, the World Bank's World Governance Indicators (WGI) project facilitated researchers by providing data for the six governance dimensions, as Subsection 3.2.2 reports in detail. The six indices have become very popular among researchers since there are available for an extensive sample of countries and provide a reliable assessment of the six dimensions of the institutional framework (Méon and Sekkat 2007; Mengistu and Adhikary 2011).

Finally, the findings of the review of the empirical literature are presented through a synthesizing framework, answering the paper's research question (please see Subsection 3.2.2)

3.2.1 Host Country's Political System and FDI Inflows

Across the voluminous literature on the motivations for FDI, several studies examined the role of the host country's political regime on inward FDI. There are those supporting that autocratic policy fosters domestic capital accumulation, FDI and growth. Some autocracies and hybrid regimes appeal more to foreign investors than some democracies at a comparable development level. Countries like China, Indonesia, Malaysia, and Vietnam have attracted inward FDI under forms of authoritarian rule (Yu Zheng 2011, p. 294). Some authoritarian countries followed efficiency-strengthening policies to provide an improved business environment for fostering domestic and foreign investments. They became more flexible in adopting and implementing the new market-friendly policies despite any opposition from domestic actors, and they even managed the volatility of their macroeconomic environment successfully (Sejedashkan Madani and Mahya Nobakht 2014, p. 77).

Early studies described the relationship between foreign investors and autocrats as a cosy relationship and that investor-state collusion shields foreign capital in authoritarian countries (Guillermo O'Donnell 1978). MNEs enter into an autocracy because of the government's capacity to crush labour demands, rule against protesters, and legislate tax laws to serve foreign investors' interests (Stephan Haggard 1990; William Greider 1997). Autocracies are better hosts of MNEs because of the expected high political risks of democracies (Jensen et al. 2012, p. 8). The high democratic risk, also described as the "benefits of authoritarian rule", falls into the three following categories (Jensen et al. 2012, pp. 8-9).

i) The first is policy instability. It is greater under democratic rule due to the government turnovers from one political party to another and manoeuvres before elections, leading even to the nationalization of companies. This feeling of unpredictable policy environments creates uncertainties for investors.

ii) The second refers to the ability to compete with interest groups to push unfriendly policies on MNEs.

iii) The third is the redistribution "card" that populists in democratic regimes play in a tricky way, usually serving their political parties' interests.

Some autocracies are willing to compete with democracies for the share of FDI by implementing liberal economic policies and engaging in international investment treaties. When a host government is highly committed to future economic policies conducive to MNEs' interests, there is a potential for higher levels of inward FDI (Jensen 2008b, p. 1043). In autocracies, the risk of non-compliance to the treaty is high, though less in cases of a high level of public deliberation in the policymaking process. Bastiaens (2016, p. 141) supports that "(Bilateral Investment Treaties) BITs will be effective in attracting the most to authoritarian countries with high levels of public deliberation, as these regimes are credible in their liberal economic policy commitments". Recently, there are new regime forms rooted in the concept of authoritarianism identified with adjectives such as "electoral authoritarianism" or "centre authoritarianism with subnational democracy", "semi-authoritarianism", or "competitive authoritarianism" (Bogaards 2009, p. 406). These are weak forms of authoritarianism since they include formal democratic institutions and must not be ignored in examining the relationship between the political system and the FDI.

Although authoritarian legislatures lead to misunderstanding as they may seem to impose constraints on the gluttonous appetites of authoritarian leaders, their positive contribution is towards the strengthening of corporate governance rules and not to the risk of expropriation (Jensen, Edmund Malesky, and Stephen Weymouth 2014, p. 656). This is opposed to MNEs' expectations of a long-lasting and robust ownership stake in a venture in a host country. Foreign firms are motivated by long-term government policy's credibility safeguarded by institutional checks, an institutional advantage of democracies (Zheng 2011, p. 294). Independent judiciaries, respect for the law, and individual rights to property and contract guarantee long-term protection of inward FDI in consolidated democracies (Mancur Olson 1993, p. 572).

Contrary to the argument of authoritarianism's benefits, the political risk under democracy is reduced because of four factors (Jensen 2008b, p. 1041). The first is that under democracy host country's policy is relatively stable and credible; the second refers to the ability of foreign firms to influence policy outcomes; the third is the openness and transparency that characterize policy and politics; the last address to governors in democratic regimes that they want to avoid the reputation costs and show unwillingness in expropriating multinational assets.

Another dimension in the MNEs' change of interest from non-democratic states to more democratic is given by Depora Spar (1999), although it lacks reliable empirical evidence. MNEs' interest in investing in repressive regimes changed over the years as a shift occurred in the structure of FDI flows from the primary sector toward the other two sectors of the economy (Spar 1999, p. 61). During the 1970s, foreign investors' interests were mainly in raw materials, and as such extractive MNEs did not hesitate to build strong relationships with the non-democratic governments of countries with abundant natural resources. While in the 1980s and 1990s, MNEs' motives and interests moved to technology-intensive manufacturing and services where a much wider range of investment sites existed than those in raw materials permitting MNEs to be less dependent on host governments' level of relationship and rule of governance (Spar 1999, p. 62). This tendency, combined with MNEs' anxiety to avoid activism protests for their investments in non-transparent and non-democratic regimes, led foreign agents gradually to keep a distance from them (Matthias Busse 2003, p. 22).

Many scholars insist on the distinct positive association between democracy and FDI (Olson 1993; Feng 2001; Philipp Harms and Heinrich W. Ursprung 2002; Jensen 2003, 2008a, b; Busse 2004; John S. Ahlquist 2006; Jakobsen and de Soysa 2006; Choi 2009; Andrew Kerner 2014). In supporting this argument, Jensen (2003; 2008b) and Li (2009b) pointed out the low country risk a democracy holds. Jensen (2003, p. 612) stressed the lack of empirical evidence on MNEs' preference to invest in autocracies over democracies. Ahlquist (2006, pp. 698-700) proved the significant positive relation of a democratic regime on FDI, including in his research MNEs' experience with to host country's decision-making environment. Thus, MNEs with long experience in democratic countries tend to invest more in them.

Positive and negative relations of democratic institutions with inward FDI may exist. Li and Resnick's (2003) analysis' produced both positive and negative relations of democratic institutions with inward FDI and motivated Choi and Samy (2008) and

Choi (2009) to provide evidence for specific attributes of democracies that are positively related to FDI.

A democratic political system by itself is not as decisively significant as the political factors that are integrated into the liberal democratic institutions, establishing a favourable investment environment (Biglaiser and Staats 2010; Moon 2015; Nazif Durmaz 2017). Hence, property rights protection, the rule of law, and the reliable court system reduce MNEs' concerns about the risk and their decision to invest (Biglaiser and Staats 2010, pp. 518-519).

Although democracies establish a better environment for foreign investors, the role of the sectoral composition of FDI must not be ignored (Heiner Schulz 2009; Asiedu and Lien 2011). Research on the nexus regime type – inward FDI excluded the distinction between different types of FDI (Schulz 2009). Hence, the aggregate effect of regime type on FDI flows may be positive, negative, or neutral depending on the sectoral composition of FDI. Schulz (2009) provided evidence that a democracy positively affects the market- and efficiency-seeking FDI but negatively affects resource-seeking FDI. In the same line of argument, democracy stimulates inward FDI flows in countries where the share of natural resources in total exports is low (Asiedu and Lien 2011, p. 109).

There is no evidence of a systematic relationship between democracy and inward FDI, at least for developing countries (Benhua Yang 2007). Democracy stimulates inward FDI in the short-run, whereas a military government stimulates inward FDI in the long-run (Uddin et al. 2019, p. 355). Maybe it is not the democracy itself but the political similarity between the home and host countries that attract FDI (Trung A. Dang 2015).

Finally, the regime type is not a significant indicator of FDI (John R. Oneal 1994; Witold J. Henisz 2000; Biglaiser and Karl R. DeRouen 2006; Vincent Arel-Bundock 2017). Henisz (2000) employed a new objective measure of particular interest to the formation of global business strategy (host policies that threaten the expected returns of the FDI) and not to the political regime conflict (autocracy *versus* democracy).

The existing research on the relationship between the host country's political regime type and inward FDI produces contradictory results mainly to the zenith of confusion in current regime classifications and the lack of a systematic way of measuring the new mode of autocratization (Lührmann and Lindberg 2019, p. 1097). However, it seems to support the positive impact of a democratic regime on FDI inflows, supplemented by other factors, as well. Therefore, this review chooses to go beyond the type of political regime on specific political determinants for defining inward FDI's variations.

3.2.2 Important Political Determinants of Inward FDI

The empirical review distinguishes four political variables. These are property rights protection, the signing of Bilateral Investment Treaties (BITs), human rights, and governance. The signing of the BITs is related to property rights protection, though BITs' underlying importance requests an independent investigation. Governance includes various dimensions that gauge the quality and strength of the host countries' political institutions, reflecting their governmental agenda as their political regime type defines it. Governance dimensions are measured by the World Bank's World Governance Indicators (WGI), a popular database among scholars due to the availability of reliable data for an extensive sample of countries (Méon and Sekkat 2007; Mengistu and Adhikary 2011). These are voice and accountability, political stability, government effectiveness, regulatory quality, the rule of law and control of corruption. These variables are attributes of the political system in general and not of a specific type of political regime.

The four distinguished political factors in host counties' political surroundings contribute to their regime's institutional stability and credibility and, thus, influence the distribution of inward FDI flows. While there are certainly others, the specific ones are the most frequently cited and empirically tested through this sample of empirical studies (please see Table A1 in the Appendix). Important explanatory variables of FDI, which also receive attention, like market size, trade openness, market instability, fiscal rules and taxation, are associated more with economic and fiscal factors and are not recorded in the analysis below due to space limitations. Finally, the reviewed empirical studies focus on regime-type democracy *versus* authoritarianism and do not consider variations of democratic systems of government (presidential *versus* parliamentary; unitary *versus* federalist) for defining the impact of the host country's political environment on FDI. Therefore, these forms of government are not reported among the distinguished political variables of this study, again due to space limitations.

Property-Rights

Host countries may follow two substitute or complementary ways to attract FDI (Jennifer L. Tobin and Susan Rose-Ackerman 2005, p. 5). The first is for host countries' governments to establish favourable FDI conditions – this does not apply to all investments – and the other is to reduce countries' risk by improving the political and economic environment. Politically unstable countries must convince MNEs of their intention to commit to legislation for property rights protection and reducing the risk of expropriation. Since FDI ideally requires the acquisition or creation of productive capacity in a long-term horizon, implying the possibility of losing some assets during their removal, this fact generates the "obsolescing bargain". Raymond Vernon defined this term in 1971, meaning once an MNE undertakes an FDI, part of the bargaining power moves on to the host country's government, which can change unexpectedly to its advantage the terms of the investment (Büthe and Milner 2008, p. 743). Expropriation may benefit the government directly by adding revenue to state accounts and enhancing domestic ownership. Although globalization increased the flows of FDI, it has not reduced the risk of expropriation. FDI remained vulnerable to outright expropriation, especially in extractive industries, no matter the hazard mitigating measures taken by MNEs (Li 2009b, p. 1099).

The definition of well-enforced property rights reduces the risk of MNEs investing in a foreign market. Since property rights enforcement minimizes the expropriation risk, the inward FDI rises (Biglaiser and DeRouen 2006). There is also a positive association between intellectual property rights (IPR) protection to the FDI's volume and composition (Nieman and Thies 2019).

The risk of expropriation occurs both in autocracies and democracies, though rarely in the latter (Li 2009b, p. 1120). A democratic political system surpasses an authoritarian one in attracting FDI due to institutional advantages in effectively defining property rights protection (Ali, Fiess, and MacDonald 2010, p. 204). Many empirical studies (Li and Resnick 2003; Jakobsen and de Soysa 2006; Jensen 2008b; Ali, Fiess, and MacDonald 2010) conclude that well-established democracies define property rights protection and build strong underpinnings for an ideal environment for foreign investors. When a country is highly committed to property rights protection, foreign investors will not have to face the arbitrary seizure of tangible and intangible goods by the state (Li and Resnick 2003, p. 202). Li and Resnick's (2003) research findings are conflicting by proving positive and negative associations between democratic institutions and FDI inflows, though they have implications for transition countries. Transitional economies must convince foreign investors to believe their property rights protection is credible. Only by establishing consolidated democracy, will a host government manage to provide offsetting improvements in property rights protection and sustain the prospect of getting more FDI inflows (Li and Resnick 2003, p. 203). Jakobsen and de Soysa (2006), motivated by Li and Resnick's (2003) study, concluded the positive association between democracy and property rights protection. Jensen (2008b) revealed a strong correlation between democratic institutions and lower levels of political risk and the importance of imposing constraints on executives in reducing risks for MNEs. Biglaiser and Staats (2010) also identified property rights protection as the most determining factor for the rise of inward FDI in any given country, though they disregarded the importance of the regime type.

Building domestic institutions to protect property rights is not just a privilege of democracy (Moon 2015, 2019). Autocracies can establish institutions similar to democracies and receive inward FDI. In fact, autocracies with long-term horizons can be recipients of more inward FDI flows than autocracies with short-term horizons (Moon 2015, 2019).

The effect of property rights on FDI is time-varying and conditioned by the institutional structure and legitimacy of the country's regime type (Nieman and Thies 2019, pp. 15-16). Nieman and Ties' (2019) empirical approach to both democracy and autocracy's capacity to stimulate FDI inflows emphasizes that there is a change-point sometime between 1990 and 2000 on the effect of regime type on attracting FDI and identifies this in the year 1995. It associates the post-1995 period with the advent of technological advances in information and communication technologies. Their empirical results point out that before 1995 all regime types had a negative marginal effect on the relationship between property rights and FDI; autocracies held the less negative effect. However, after 1995, democracies recorded having a positive marginal effect on this relationship.

Bilateral Investment Treaties (BITs)

BITs an Institutional Device

BITs originated between developed and developing countries, meaning between the primary sources of FDI and vulnerable and risky business markets. The conclusion of the first BIT was between Germany and Pakistan in 1959, and its implementation occurred in 1962 (Peter Egger and Michael Pfaffermayr 2004, p. 789). Over the past two decades, BITs evolved as an institutional device and have become the dominant international legal tool to stimulate FDI flows (Srividya Jandhyala, Henisz, and Edward D. Mansfield 2011). This context refers to establishing a broad set of investors' rights that permit investors to sue a host government in an international tribunal in case of these rights' violation (Kerner 2009, p. 73). BITs include certain guarantees for investors from the signatory countries, such as the right to transfer funds and assets freely, minimum treatment standards, protection from expropriation and mostly the right to international arbitration (Liesbeth Colen, Damiaan Persyn, and Andrea Guariso 2016, p. 194). Hence, BITs guarantee to reduce the risk of an investment that the "obsolescing bargain" produces.

The United Nations Conference on Trade and Development (UNCTAD 2009) survey reports that MNEs recognize BITs as a commitment instrument in host developing countries and transition economies. UNCTAD supported the expansion of BITs by organising meetings in which developing and transition countries concluded in BITs, not only with each other but also with the developed countries (Ryan J. Bubb and Rose-Ackerman 2007, p. 292). Most ratified BITs include similar provisions as they are conducted following the model treaties developed in home countries of great MNEs' (Tobin and Rose-Ackerman 2005, p. 7).

Institutions like BITs effectively restored the reputation and credibility of unilateral FDI-related measures of transition economies after the fall of centrally administered socialism (Axel Berger et al. 2011, p. 272). Besides, institutions are more valuable commitment devices for non-democracies, which have fewer mechanisms to communicate with credibility their resolves to international audiences (Songying Fang and Erica Owen 2011, p. 160).

BITs and Inward FDI

Foreign investors tend to invest in authoritarian countries that are constrained from "above" and "below" (Bastiaens 2016, p. 141). By signing an international investment treaty, authoritarian regimes reduce foreign investors' expectations of profit loss due to insecure property rights protections. However, in such regimes, there is always the risk of non-compliance by the authoritarian leader. The high level of public deliberation in the policymaking process of the authoritarian signatory country can ascertain foreign investors for the treaty's effectiveness. The significance of the public deliberation theory in addressing issues like the country's economic instability and growth is reported in Siddharth Chandra and Nita Rudra's (2015) work. Bastiaens (2016, p. 142) concludes that "in the long-run, authoritarian countries with ratified bilateral investment treaties (BITs) and high levels of public deliberation receive greater inflows of FDI than authoritarian regimes with bilateral investment treaties and low levels of public deliberation".

There is a positive relation between BITs and FDI (Grosse and Trevino 2005; Eric Neumayer and Laura Spess 2005; Salacuse and Sullivan 2005; Büthe and Milner 2008; Kerner 2009; Rod Falvey and Neil Foster-McGregor 2017). Salacuse and Sullivan (2005) defined the positive contribution of BITs to inward FDI by assessing BITs' effectiveness in relation to their intended goals of foreign investment protection, investment and market liberalization, and investment promotion. BITs' positive impact on FDI inflows is mainly found in developing countries that sign BITs with developed countries (Neumayer and Spess 2005). In the same line of argument, Grosse and Trevino (2005) provided evidence for the positive relationship between the singing of the BITs and FDI, for 13 countries of Central and Eastern Europe (CEE), during 1990-1999. MNEs regard BITs as facilitators to invest as they reduce the cost of doing business in CEE.

The direct and indirect channels of influence, meaning the *ex post* costs to violate BITs and *ex ante* political costs borne by politicians who pursue them, play an essential role in the positive relation of BITs to FDI (Kerner 2009). In this context, non-transparent countries with weak institutional and policy environments seek to sign BITs to establish stability, transparency, and credibility for foreign investors. In democracies with a conducive investment environment, entering into BITs will not substantially change the amount of inward FDI (Rosendorff and Shin 2012). There is a positive effect of BITs on bilateral flows of FDI, though it may disappear if large differences in the strength of political institutions between source and host countries exist (Falvey and Foster-McGregor 2017, p. 653).

The risks to which MNEs are exposed to the host country determine a BIT's effectiveness as a commitment device. Rodolphe Desbordes and Vincent Vicard (2009) are concerned in their analysis of the two kinds of political risks that usually confront foreign investors in host countries; thus, the systematic domestic risk, referring to the quality of domestic institutions and the idiosyncratic risk resulting from interstate political relations. The latter is considered to have a high impact on the investment locational decision-making process of MNEs. BITs manage to increase the volume of bilateral FDI by preventing political juxtaposition between countries that usually lead to expropriation risks and by maintaining good quality in domestic institutions. They focused on the quality of political relations between the signatory states as a stimulant to FDI. BITs have a more significant impact on inward FDI between countries with political tensions, whereas they are insignificant between friendly countries. Additionally, they found evidence of the complementarity of BITs to strong domestic institutions (Desbordes and Vicard 2009, p. 383).

BITs are not delivering the expected benefits on FDI in all cases (Mary Hallward-Driemeier 2003; Tobin and Rose-Ackerman 2011). Hallward-Driemeier (2003) examines bilateral FDI flows for a small sample of host countries and finds little support for the effectiveness of BITs. In particular, ratified BITs act complementarily to property rights in countries with weak domestic institutions, while countries with solid domestic institutions gain even more from ratifying a treaty. The weak relationship between BITs and FDI is also described by Tobin and Rose-Ackerman (2005), stressing the importance of political stability. The signing of a BIT is not enough to acquire a larger share in inward FDI if the country has not achieved its political stability first. BITs' contribution to inward FDI growth must be examined within the context of its political, economic, and institutional environment and in the light of the global BITs regime (Tobin and Rose-Ackerman 2011, pp. 28-29). Hence, as the coverage of BITs increases, overall FDI flows to low- and moderate-income countries increase (Tobin and Rose-Ackerman 2011, pp. 28-29)

Most of the literature concludes on the effectiveness of BITs in attracting FDI, especially for countries with inadequate mechanisms to communicate their resolves to international audiences with credibility. Developing countries and countries in transition with non-democratic regimes are usually the case.

Human Rights: Political Participation, Civil Liberties, and Labour Rights

The conventional assumption implies that states repressive to human rights best serve the interests of foreign capital. They provide a conducive business environment to MNEs who benefit from low labour costs being formed below the prospective market equilibrium and oppression of labour rights (Blanton and Blanton 2007, p. 144). However, the perspective of this symbiotic relationship between a repressive government and FDI is questioned (Blanton and Blanton 2007, p. 145). David Kucera (2002) finds no solid evidence in support of conventional wisdom.

The respect for human rights, as a factor in MNEs' location decisions, explains the variation in the attractiveness of countries for FDI. Host countries with respect to human rights, with guarantees of political participation and civil liberties, enhance political stability and predictability and decrease investors' vulnerability to the costs associated with public sensitivity to human rights repression (Blanton and Blanton 2007, p.144). Ana Carolina Garriga (2013) includes the issue of foreign investors' reputational concerns in discussing human rights violations' influence on FDI. Garriga's empirical work in developing non-OECD countries supports the argument that violations of physical integrity rights in countries characterized by a low commitment to human rights regimes work as a deterrent to FDI.

Well-defined political and labour rights boost inward FDI (Dani Rodrik 1996; Harms and Ursprung 2002; Busse 2003, 2004). Foreign investors' interest is more in countries respecting civil liberties and political rights and organized labour force than in repressive regimes imposing high constraints on residents' fundamental human and democratic rights (Harms and Ursprung 2002, p. 653). In this line of argument Busse (2003, 2004) concluded that countries with improving democratic rights and liberties receive a larger volume of FDI per capita than will have been predicted based on other country characteristics. Busse (2004) linked democracy and FDI by using the two separate indicators of civil liberties and political rights provided by Freedom House. Antonis Adam and Fragkiskos Filippaios' (2007) research included the same indicators but concluded that MNEs tend to invest in democratic countries with high political rights but low civil liberties.

Political rights and civil liberties contribute to FDI's growth in transition economies (Mike Pournarakis and Nikos Varsakelis 2004; Pajunen 2008; Tintin 2013). Pajunen (2008), on the same group of countries, identified these two institutional variables to exhibit causal relevance as a fundamental cause for becoming an FDI-attractive country (Pajunen 2008, p. 663). Tintin (2013, p. 297) examined political rights and civil liberties, with economic freedom and the state's vulnerability, and concluded the positive relationship between the two variables and FDI inflows in CEEC (Tintin 2013, p. 297). Pournarakis and Varsakelis (2004) concluded that the more improvements in the civil rights level of a transition country in the CEE, the more positive the impact of an increase in *per capita* income on FDI.

Madani and Nobakht (2014), in their research on political regimes-inward FDI nexus for the Upper Middle-Income Countries (UMCs), used civil liberties and political rights for the measurement of the types of political regimes (democracies or autocracies). They revealed the importance of the quality of political institutions in recipient countries, and their findings favour democratic regimes attracting higher levels of FDI than autocratic ones. In the same line, Durmaz (2017), using the two popular indices, examined democracy and FDI for Turkey. A more structured and stable government with policies and institutions would provide improved political rights and more civil liberties support the country's development as a recipient of FDI (Durmaz 2017, p. 242).

The economic externalities generated concerning human rights make countries attractive hosts of FDI (Blanton and Blanton 2006, 2007, 2009). Human rights act complementarily to political institutions in establishing a favourable FDI environment, unlike countries under oppression (Blanton and Blanton 2006, 2007). Blanton and Blanton (2007) examined the relationship between FDI and human rights in non-OECD countries. They found that developing countries that respect human rights succeed in receiving more FDI than those in which human rights are curtailed. Furthermore, Blanton and Blanton (2009) concluded that human rights could be a significant determinant of FDI across sectors that value higher skills and integration within the host society.

A high level of labour rights challenges MNEs' location decisions (Blanton and Blanton 2012; William W. Olney 2013). Blanton and Blanton (2012) proved that labour rights are negatively and significantly related to total FDI and FDI in the services sector and *vice versa*, though a positive relationship exists in manufacturing investments. There is a "race to the bottom" dynamic concerning the FDI-labour rights nexus. MNEs' decision to invest in a stable society with a skilled labour force does not connote they favour for labour rights. MNEs prefer to invest more in countries with a decreased level of labour rights, which investments further undermine labour rights (Blanton and Blanton 2012, p. 288). Olney (2013, p. 203) proved the negative relationship between a high level of labour rights and inward FDI and that countries implementing FDI-friendly strategies are competitively limiting labour rights. On the contrary, Busse, Peter Nunnenkamp, and Mariana Spatareanu (2011) conclude that labour rights limitations, such as freedom of association and objective bargaining, discourage FDI inflows.

Governance

Daniel Kaufmann, Aart Kraay, and Pablo Zoido (1999) organized and summarized the different indicators of governance that existed in the 1990s based on individual notions. This effort led to the production of the Worldwide Governance Indicators (WGI) project that has been covering over two hundred countries and territories since 1996, for six dimensions of governance: Voice and Accountability, Political Stability and Absence of Violence/Terrorism, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption (Kaufman, Kraay, and Massimo Mastruzzi 2011; Kaufmann and Kraay 2021). Across the literature, these indicators are used to examine the inward FDI-political environment nexus. Also, the variables of veto players and audience costs are included in assessing the quality of governance in research on the same issue. Finally, some studies use similar indicators, e.g., corruption instead of control of corruption, law and order, instead of the rule of law from a different data source.

Democracies, as more credible regimes than autocracies, receive more inward FDI flows (Jensen 2003, 2008b). A supportive mechanism for a democratic regime's high credibility is the number of veto players it involves (Jensen 2008b, p. 1041). Chambers of the legislature, a supreme court, separation of the executive and legislative branches of government, or federal actors are included in the veto players (Jensen 2003, p. 594). Veto players ensure the host government's credibility by assuring foreign investors that policies cannot be reversed after entering the country (Jensen 2003, 2008b). The opposite case will harm the reputation of the democratic government. The level of government commitment to policy stability is an essential component of the regime's credibility, referring to the political process of "audience costs". If democratic leaders decide to renege on the contracts made with MNEs, they get a bad reputation both inside and outside the country which will cost them in the elections (Jensen 2003, pp. 594-595). This cost-benefit calculation constraints governments' opportunistic behaviour. Choi and Samy's (2008) empirical work for developing countries share the argument on veto players' contribution to the country's institutional credibility and, as a consequence of the rise of FDI, but do not agree on the positive relation between audience costs and FDI.

The governance variables positively affect inward FDI (Christian Daude and Ernesto Stein 2007; Azmat Gani 2007; Mengistu and Adhikary 2011; Jensen et al. 2012; Uddin et al. 2019). Daude and Stein (2007) proved that the indicators of WGI, regulatory quality followed by government effectiveness, act as the most potent stimulants of inward FDI. Uddin et al. (2019) highlighted the significance of regulation as an institutional variable affecting inward FDI flow for Pakistan, while Shan Shan et al. (2018) indicated the voice and accountability in attracting Chinese FDI in Africa. Staats and Biglaiser (2012) identified the importance of the rule of law to inward FDI in Latin America. The greater the judicial strength and the rule of law in the host country, the higher the FDI it receives (Staats and Biglaiser 2012, p. 200). Governance indicators such as the rule of law, control of corruption, regulatory quality, government effectiveness and political stability are positively related to FDI in Asian and Latin American countries (Gani 2007, p. 756). Mengistu and Adhikary (2011) provided tangible evidence for political stability and the absence of violence, government effectiveness, the rule of law, and control of corruption as indicators of the quality of governance that have a significant role in attracting inward FDI. Finally, credible government policies and the improved rule of law contribute most to transforming Eastern Europe and Eurasia post-socialist countries into FDI recipient countries (Michael Touchton 2015).

Specific governance dimensions have a more significant impact on FDI inflows than others (Busse and Carsten Hefeker 2007; Melo and Quinn 2015; Chengchun Li, Syed Mansoob Murshed, and Sailesh Tanna 2017). Busse and Hefeker (2007) explored the role of political risk and institutions in host countries as determinants of FDI for developing countries. Among the indicators of political risk and institutions they examined, government stability, internal and external conflicts, law and order, ethnic tensions, and quality of bureaucracy are the highly significant determinant of inward FDI while, to a lesser degree, corruption and democratic accountability (Busse and Hefeker 2007, p. 412). Li, Mushed, and Tanna (2017) differentiated from Busse and Hefeker's empirical study by disaggregating FDI inflows into various types and examining the impact of civil war on inward FDI into the three economic sectors. They concluded that government stability and control of corruption are more significant institutional variables in attracting inward FDI in developing countries than law and order, bureaucratic quality and a democratic political system (Li, Murshed, and Tanna 2017, p. 503). The parameter of the productive economic sector recently became popular in examining FDI and the quality of governance relationships. In this context, Melo and Quinn (2015), discovering how corruption affects FDI inflows, brought to light the case in which MNEs pursue natural resources. Corruption produces additional costs and risks in government institutions, deterring FDI inflows. Nevertheless, if a country is a significant oil producer, then corruption becomes insignificant to extractive MNEs (Melo and Quinn 2015, p. 46).

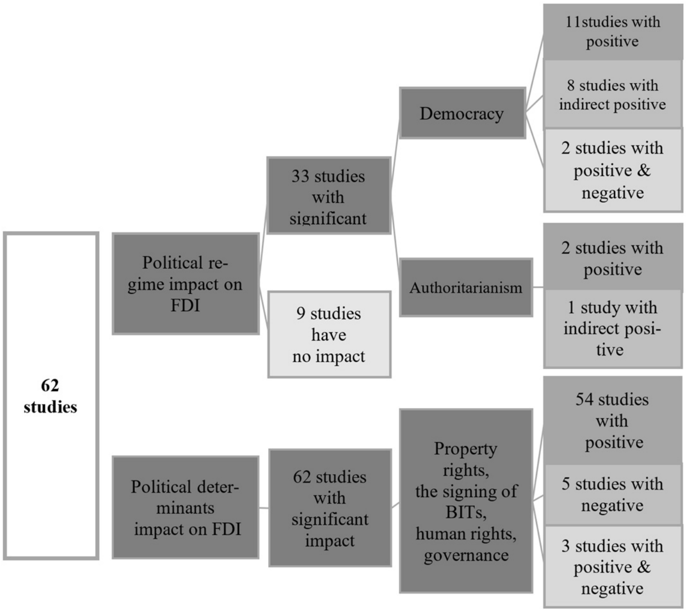
Regarding corruption, Méon and Sekkat (2005) insisted that a country suffering from poor governance, meaning a weak rule of law, an inefficient government and political violence, produces high corruption, discouraging inward FDI. Contrariwise, Egger and Hannes Winner (2005) identified a positive long-run impact of corruption on a host developing country's attractiveness for foreign agents from developed countries. MNEs may accept the host country's corruption practices to promote their interests; thus, corruption acts as a "helping hand" to increase profits. Since MNEs' profits outweigh their costs, corruption will increase FDI (Egger and Winner 2005, p. 935). This positive relationship between corruption and inward FDI, Sotirios Bellos and Turan Subasat (2012) also discover in their research for European transition economies. In these economies, the low quality of governance generates problems that corruption can compensate for by accelerating processes in a sluggish administration, skipping the restrictive, bureaucratic regulatory framework, providing incentives to poorly paid civil servants and giving the license of a competitive auction to the more generous bribe (Bellos and Subasat 2012, p. 566). Hence, in economies with transitional problems, corruption can stimulate FDI inflows.

Nevertheless, most existing research for transition economies presents the opposite outcome for corruption as a determinant of FDI. Especially in their early transitional days, the big government's corruption hindered any effort to implement structural reforms for their regime change and establish a market economy (Bitzenis 2006). Joel S. Hellman, Geraint Jones, and Kaufmann (2002, p. 21) suggested that corruption decreases inward FDI and attracts lower quality investment in governance standards. This investment can generate state capture and more corruption (Hellman, Jones, and Kaufmann 2002). Less corrupt transition economies (such as Estonia or the Czech Republic) attract more FDI than more corrupt transition states (such as Azerbaijan or Uzbekistan) (Beata SSmarzynska Javorcik and Shang-jin Wei 2009).

Governance indicators that enhance good governance are more important in determining FDI inflows than the political regime's democratic spirit (Busse and Hefeker 2007; Mengistu and Adhikary 2011; Mumtaz Hussain Shah and Anum Gul Afridi 2015; Li, Murshed, and Tanna 2017; Rodríguez-Pose and Cols 2017; Nicholas Bailey

2018). The regime type and favourable policy mix are essential in stimulating inward FDI, though the quality level of governance that enhances the rule of law limits corruption and ensures political stability becomes the most important determinant of FDI (Mengistu and Adhikary 2011, p. 295).

Figure 1 presents the literature review findings shortly, while Table A1 in Appendix provides more details about the studies. Notably, of the reported studies, 33 examine the impact of political regimes on FDI, including the four political determinants. In particular, 11 of these papers find a positive impact of democracy on FDI, eight an indirect positive impact, and two both positive and negative. Two of these papers find a positive impact of authoritarianism on FDI, while one has an indirect positive impact. Nine studies determined an insignificant role of the regime on FDI. Concerning the impact of the four political variables on FDI, in the total of 62 studies, three of these papers found both positive and negative impacts; five concluded with negative impact, while 54 to a positive impact on FDI.



Note: Authors' elaboration from Table A1, Appendix.

Figure 1 Literature Findings on the Impact of Regime and Political Determinants on Inward FDI

Therefore, incorporating the four political determinants in the research for the impact of the host country's political environment on inward FDI increases the possibilities for the extraction of conclusive results below.

4. Concluding Remarks

The paper's primary concern is to provide underpinnings for further research on inward FDI distribution in the contemporary international political scene. It focuses on the importance of specific political variables met in all political systems, not just the type of political regime, to affect the foreign investors' decision-making process. Besides any positive effect on host countries' economies, FDI inflows also record negative impacts. However, developing countries, emerging economies, and economies in transition reform their investments' regulatory framework to build an attractive investment environment aiming to gain from FDI's positive contribution to economic growth.

The political system of democracy remains the most common globally, despite the recorded democratic declines and the rise of illiberal politics. Many studies are supportive of democracies attracting more FDI than autocracies, but few provide strong empirical evidence.

This paper shares the argument of several scholars' that FDI cannot be explained by a single theory but rather by a combination of theoretical models which complement each other. To this line, identifying determinants that increase the regime's institutional stability and credibility and hence, influence the inward FDI is based on the empirical results of the extant literature. The distinguished determinants are property rights protection, the signing of BITs, human rights (political participation rights, civil liberties and labour rights), and quality of governance.

The literature review suggests that the definition of well-enforced property rights positively impacts inward FDI. The host country commits to property rights protection, decreasing the risk of an investment that the "obsolescing bargain" produces, and enhances stability and predictability for FDI by signing an international investment agreement like a BIT.

Respect for human rights is important in MNEs' location decisions and explains the variation in FDI inflows. Foreign investors' interest is more in countries with guarantees of political participation and civil liberties. Through its political system, a host country can establish institutional quality and provide political stability, judicial strength, and the rule of law, involve multiple veto players, be mindful of the audience costs, and control corruption, attracting more FDI inflows. Credible government policies and corruption control are highly significant in transition countries. However, in some cases, when bad governance exists, then corruption can overcome distortions and attract FDI.

Finally, this study sheds light on debates on the host country's political influence on inward FDI. By shaping in a better form the impact of specific political features on FDI, it expects to provide the ground for empirical research with conclusive arguments.

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Appendix

Table A1 Literature Findings on the Impact of Regime on Inward FDI based on Political Determinants on FDI

Political determinant	Studies	Political determinants				Political regime						
						Impact on FDI						
		(+)	(-)	(+, -)	Ns	(+)		(-)		(+, -)		Ns
						D	A	D	A	D	A	D, A
Property-rights protection	Li and Resnick (2003)	●								●		
	Jakobsen and de Soysa (2006)	●				●						
	Biglaiser and DeRouen (2006)	●										●
	Jensen, (2008b)	●				○						
	Li (2009b)	●				○						
	Ali et al. (2010)	●										⁕
	Biglaiser and Staats (2010)	●				○						
	Moon (2015)	●										●
	Moon (2019)	●					○					
	Nieman and Thies (2019)	●								●		
The signing of BITs	Hallward-Dreimeier (2003)	●										⁕
	Grosse and Trevino (2005)	●										⁕
	Neumayer and Spess (2005)	●										⁕
	Salacuse and Sullivan (2005)	●										⁕
	Tobin and Rose-Ackerman (2005)			●								⁕
	Büthe and Milner (2008)	●										⁕
	Desbordes and Vicard (2009)	●										⁕
	Kerner (2009)	●				●						
	Berger et al. (2011)	●										⁕
	Jandhyala et al. (2011)	●										●
	Tobin and Rose-Ackerman (2011)	●										●
	Rosendorff and Shin (2012)	●					●					
	Bastiaens (2016)	●					●					
	Falvey and Foster-McGregor (2017)	●										⁕
Human rights	Rodrick (1996)	●				●						
	Harms and Ursprung (2002)	●				●						
	Kucera (2002)	●										⁕
	Busse (2003)	●				●						
	Busse (2004)	●				●						
	Pournarakis and Varsakelis (2004)	●										⁕
	Adam and Filippaios (2007)			●		○						
	Pajunen (2008)	●										⁕
	Blanton and Blanton (2006)	●										●
	Blanton and Blanton (2007)	●										●
	Blanton and Blanton (2009)	●				○						
	Busse et al. (2011)	●										⁕
	Blanton and Blanton (2012)		●									●
	Olney (2013)		●									⁕
	Garriga (2013)	●				○						
	Tintin (2013)	●										⁕
	Madani and Nobakht (2014)	●				●						
	Durmaz (2017)	●				●						
Governance	Hellman et al. (2002)		●									⁕
	Jensen (2003)	●				●						
	Egger and Winner (2005)	●										⁕
	Méon and Sekkat (2005)		●									⁕
	Bitzenis (2006)	●										⁕
	Busse and Hefeker (2007)	●				○						
	Daude and Stein (2007)	●										⁕
	Gani (2007)	●										⁕
	Choi and Samy (2008)	●				●						
	Javorcik and Wei (2009)	●										⁕

	Mengistu and Adhikary (2011)	●										✳
	Bellos and Subasat (2012)		●									✳
	Staats and Biglaiser (2012)	●										✳
	Shah and Afridi (2015)	●										✳
	Melo and Quinn (2015)			●								✳
	Touchton (2015)	●										✳
	Li et al. (2017)	●										●
	Rodríguez-Pose and Cols (2017)	●										●
	Bailey (2018)	●				○						
	Uddin et al. (2019)	●				●						

Notes: (i) **(+):** The study reports a positive impact of the regime or political determinants on FDI. **(-):** The study reports a negative impact of the regime or political determinants on FDI. **(+, -)** The study reports both positive and negative impact of the regime or political determinants on FDI. **Ns:** The study reports an insignificant impact of the regime or political determinants on FDI. (ii) ● represents the direct impact of the regime or political determinants on FDI, ○ represents the indirect impact of the regime or political determinants on FDI, ✳ the regime type is not included in the study's empirical analysis. (iii) D for Democracy, A for Authoritarian.

Source: Authors' compilation.

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