

## HAS CORRUPTION ACTED AS A NEGATIVE DETERMINANT DISCOURAGING FDI?

### Introduction

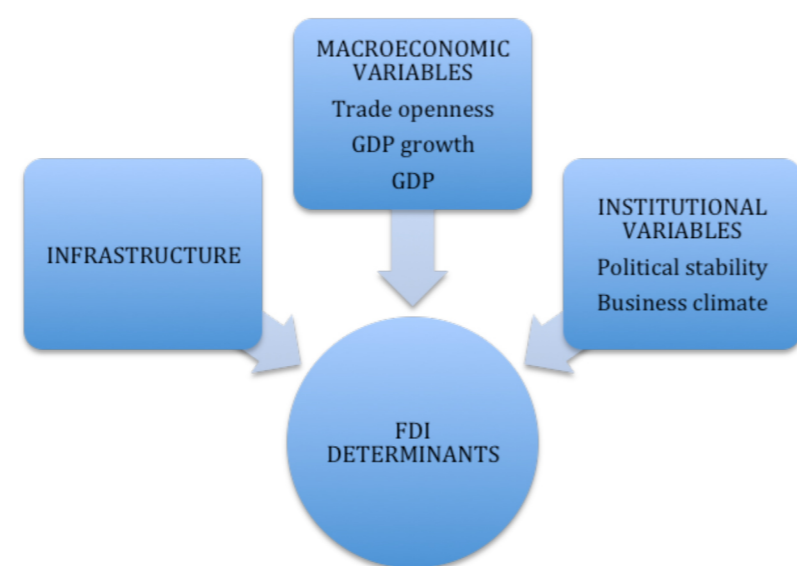
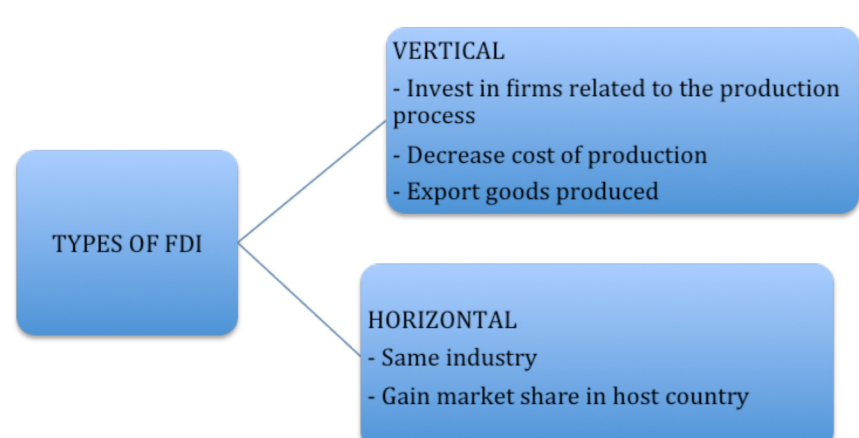
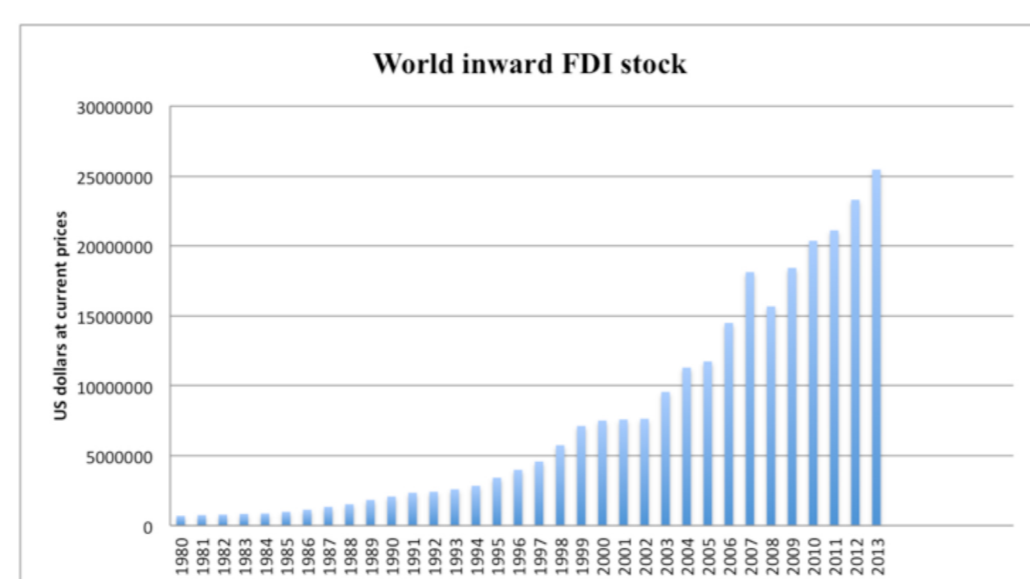
Argentina is ranked as one of the most corrupt countries in South America, although it is also the fourth largest Foreign Direct Investment recipient. We aim to analyze the role of corruption in attracting FDI in Argentina through an empirical analysis by exploiting a database in which two alternative measures of business climate are included: the Corruption Perceptions Index (CPI) and the Index of Economic Freedom (EFI).

### Methodology

- We use an Ordinary Least Squares (OLS) linear regression model creating an original database to analyze the effect that Argentina's GDP, GDP per capita and two separate business climate indices have on its inward FDI and FDI per capita between 1995-2013
- The Corruption Perception Index (CPI) captures the perception of corruption of people around the globe while the Economic Freedom Index (EFI) measures the broader business climate
- GDP and FDI in absolute values are used to account for the country size effect while FDI and GDP per capita measure the true attractiveness of Argentina regardless of its size

### Foreign Direct Investment

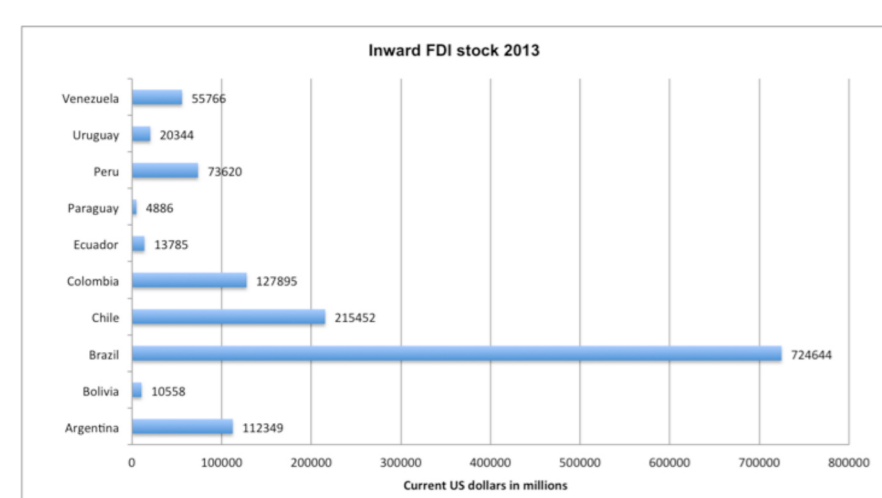
- International investment involving ownership and/or control of at least 10% of a business enterprise abroad to obtain a lasting interest
- Sharp inward FDI increase over time, rising 1,123% between 1990-2012 reaching \$1.46 trillion in 2013



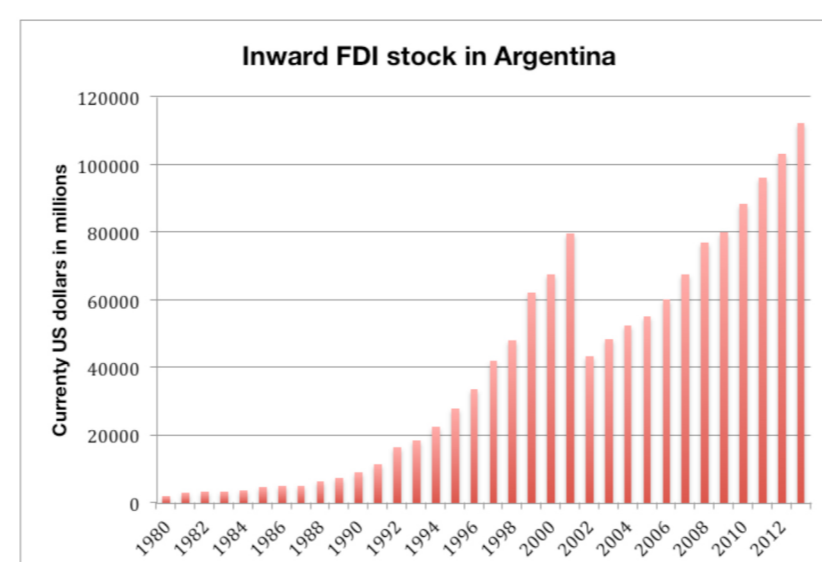
### Corruption

- Misuse of entrusted power for private gain
- Obstacle to business
- Country risk factor
- Adds uncertainty to new endeavors because of the additional and sometimes hidden costs it entails
- Important factor of the business climate, which is a crucial determinant of FDI, and regularly linked to deterring effects on inward FDI
- 1 out of 4 people worldwide reported having paid a bribe in 2013
- 53% believe corruption has increased
- Half of businesses reported more than a 10% increase in business costs due to the effects of corruption in 2009
- Firms prefer investing in countries with lower risk to make sure they get their expected returns
- Easier to gain profits in an economy with a business-friendly environment and low levels of corruption, reducing the risk and uncertainty of investment
- Business climate is the economic environment including rules and regulations in which to do business. It includes economic stability, quality of institutions and corruption level

## Argentina's Results

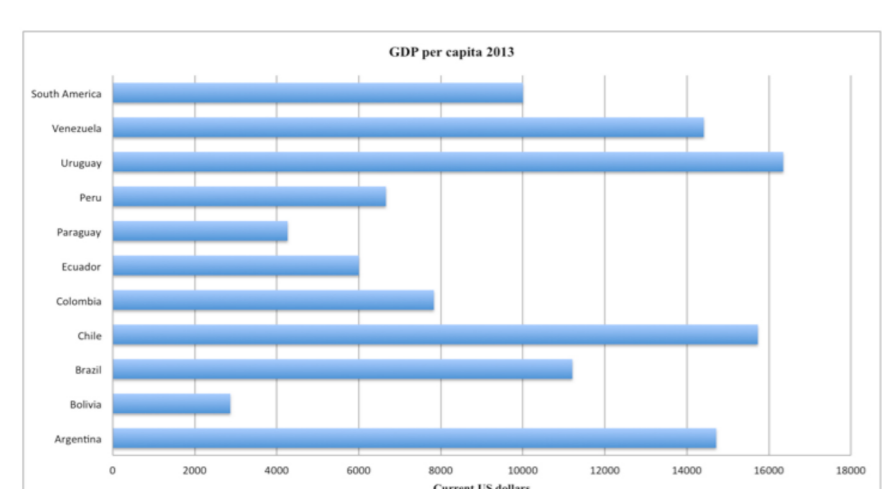


4<sup>th</sup> inward FDI recipient

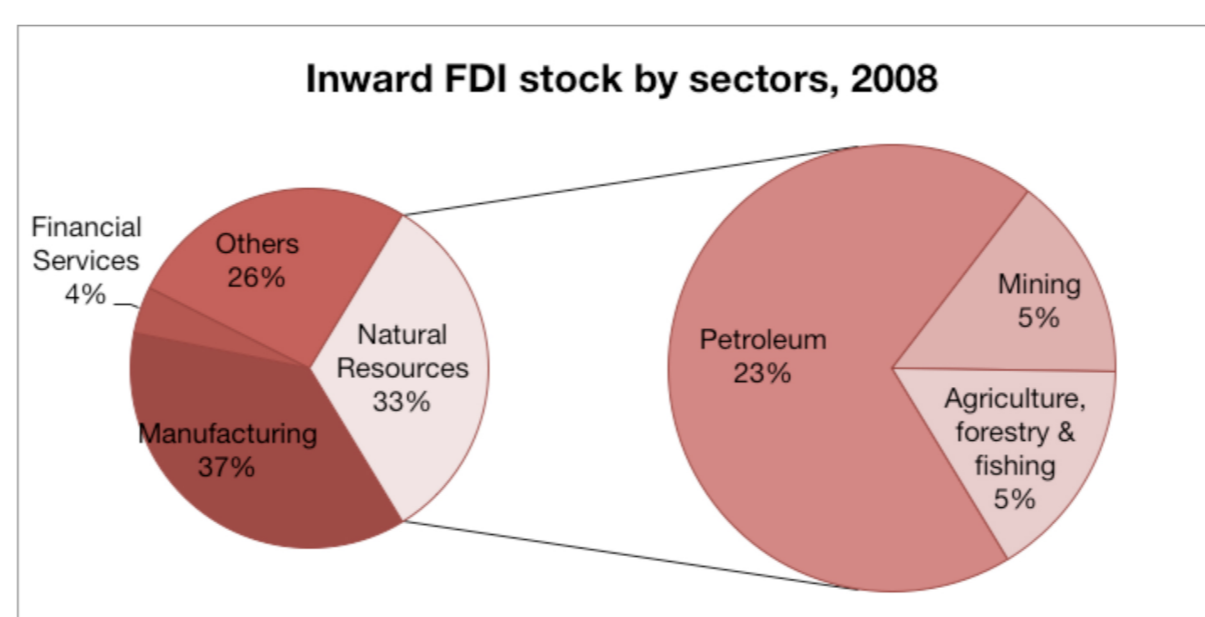


3<sup>rd</sup> most corrupt

Corruption does not impact Argentina's inward FDI negatively since its inward FDI is related to the extraction of natural resources and the oil sector is not affected negatively by corruption due to the international scarcity of these resources. Genuine attractiveness as a recipient of FDI: country size effects do not play an important role. Perceived corruption and market size explain 84% of the variation of FDI per capita in Argentina.



3<sup>rd</sup> largest market size



### Conclusions

Perceived corruption in Argentina does not deter its inward FDI, contrary to recent literature on the subject. The positive effect of corruption on FDI might be due to the type and scope of foreign investment which focuses on the exploitation of natural resources, especially in the oil sector, for which businesses are willing to make under-the-table payments. The Economic Freedom Index did not prove statistically significant affecting inward FDI given the economic-freedom factors exploited to calculate this index might not be relevant to Argentina's particular situation when dealing with corruption and its effect on FDI.