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DO DEMOCRATIC INSTITUTIONS SHAPE CAPITAL INFLOWS? EVIDENCE FROM DEVELOPING ECONOMIES

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Resumo

O fluxo internacional de capitais em direção a economias em desenvolvimento tem sido uma área de pesquisa para economistas dês da consolidação do arcabouço *Push-Pull* na década de 1990. Apesar das muitas contribuições recebidas por essa literatura ao longo dos anos, há uma visível falta de trabalhos que explorem como essa dinâmica de capitais internacionais interage com as instituições democráticas nos países recipientes desse fluxo e suas alterações ao longo do tempo. Dado que muitos países estão passando por processos de erosão em suas democracias no século 21, é de grande interesse que seja avaliado como essas mudanças podem impactar a entrada de capital estrangeiro em economias em desenvolvimento.

Para a realização deste trabalho foi utilizado o método de Projeções Locais com uma base de dados contendo 31 países em desenvolvimento de 2000 a 2020. Foram selecionados índices para qualidade de instituições democráticas visando avaliar a reação da entrada de capitais internacionais, medida por Investimento Estrangeiro Direto e Investimento de Portfolio. Os resultados mostram que boas instituições democráticas são significativas para atrair a entrada do Investimento Estrangeiro Direto para as economias emergentes, enquanto que no caso do Investimento de Portfolio, mais volátil por natureza, em geral não foi afetado pelos índices selecionados.

Palavras Chave: Fluxo de Capitais, Push-Pull, Retrocesso Democrático, Projeções Locais

Abstract

The international capital flow towards developing economies has been an area of research in economics since the consolidations of the push-pull framework on the 1990's. Despite the many contributions this literature has seen throughout the years, there is visible lack of research when it comes to understanding how this dynamic of capital inflow interacts with democratic institutions in recipient countries and how those change through time. As many countries are going through process of erosion of their democracies during the 21st century, it is of great interest to access how these changes may impact the capital flow towards developing economies.

In order to make this study the method of Local Projection was used, with a dataset of 31 developing countries from 2000 to 2020. Many indexes for quality in democratic institutions were used to evaluate the response of capital inflow, measured by FDI and Portfolio Investment. The results show that good democratic institutions are significant attractors for FDI inflow towards developing economies while the more volatile Portfolio Investment often was not affected.

Key-words: Capital Flows, Push-Pull, Democratic Backsliding, Local Projections

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List of Initials and Abbreviations

BPM6- Balance of Payments and International Investment Position Manual – Sixth Edition

BRICS- Brazil, Russia, India, China, South Africa

FDI- Foreign Direct Investment

GDP- Gross Domestic Product

GLS- Generalized Least Squares

GMM- Generalized Method of Moments

IMF- International Monetary Fund

MCMC- Monte-Carlo Markov-Chains

MINT- Mexico, Indonesia Nigeria, Turkey

OLS- Ordinary Least Squares

PCI- Portfolio Capital Investment

SVAR- Structural Vector Autoregression

US- United States

VAR- Vector Autoregression

VECM- Vector Error Correction Model

VIX-Chicago Board Options Exchange's CBOE Volatility Index

Summary

1. Introduction

Globalization and financial deregulation since the 1990s have led to a significant rise in the cross-border movement of capital. This phenomenon is mainly driven by the largest economies in the world, but developing countries have also become more involved in the global financial market, especially after the 2008 crisis (Ahmed and Zlate, 2014). Consequently, these economies have gained access to an increased amount of foreign capital which may be beneficial to their own developing process, although this dependency also exposes them to a higher risk of negative impacts from international financial downturns. Understanding the mechanisms that drive foreign capital inflow towards these developing economies then became an important area of research for economists, leading to the development of the push-pull framework.

Starting with the empirical work from Calvo et. al. (1993), several of these studies have assessed the determinants of capital inflow, ranging from external factors (described as pushing foreign capital towards developing economies) to domestical factors (responsible to pulling these investments). As the literature review section shows, much of this empirical research has been largely about economic factors that play a major role on the inflow towards developing economies as those were the basis for the consolidation of this framework. This current work, however, addresses the question of how political risk and democratic institutions affect the allocation of capital towards developing economies.

One of the most remarkable and worrisome political trends of the 21st century is the erosion of democracy in many parts of the world. Democratic backsliding, as this phenomenon has been called, refers to the gradual deterioration of democratic standards and practices by populist leaders who seek to undermine the opposition, the media, the judiciary, and civil society. By expanding their executive authority, weakening the checks and balances of the political system, and manipulating the electoral process, these leaders pose a serious threat to the quality and stability of democracy (Bauer and Becker, 2020; Bermeo, 2016). Scholars have pointed out that a diverse set of countries, such as Turkey, Venezuela, Hungary, Poland, India, United States and Brazil, have undergone a process of democratic backsliding over the last years with significant implications for their economic and social development (Luo

and Pzeworski, 2021; Milhorance, 2022). Therefore, as the process of erosion of democratic institutions occurs on developing economies it seems relevant to inquire what effects it will have on their foreign capital inflow as international investors take into account these political shifts.

Such research is by no means novelty for economists, as the relationship between democracy and economic development has been extensively studied in economic literature, with mixed and inconclusive results. Some studies suggest that democracy fosters economic growth by providing accountability, stability, and protection of property rights (Acemoglu et al, 2014; Cox and Weingast, 2018), while others argue that democracy hampers growth by creating political instability, rent-seeking, and policy uncertainty (Rachdi and Saidi, 2014).

One of the channels through which democracy may influence economic performance is the attraction of foreign capital, which can provide additional resources, technology, and know-how to the domestic economy, although few papers explore this relationship within the context of the push-pull framework, which is one the goals of this research.

Additionally, it is important to examine how shifts in democratic institutions influence foreign investors, who are more vulnerable to political uncertainty than domestic investors, as they face extra challenges of rules and regulations such as capital controls, different tax regimes and expropriation risk (Julio and Yook, 2016). However, not all types of foreign capital are equally beneficial or sensitive to the political environment. Foreign direct investment (FDI) involves the acquisition of ownership and control of assets in the host country, while portfolio capital inflows (PCI) refer to short-term and reversible flows of portfolio investment and bank lending. While FDI can generate positive spillovers and enhance productivity, PCI can be volatile and prone to sudden reversals, creating macroeconomic instability and financial crises.

Therefore, it is important to understand how different aspects of the political environment affect the composition and magnitude of capital inflows. This research aims to fill this gap by empirically examining how changes in the level of democracy, measured by some indexes such as political instability, rule of law and the existence of free and fair elections, affect the responses of FDI and PCI in a sample of 31

countries classified by the IMF as emerging market economies from 2000 to 2020. The chosen method of estimation was the Local Projections technique, which allows to estimate the impulse response functions of FDI and PCI to shocks in democracy without imposing any restrictions on the dynamic structure of the model.

The results for most of indexes chosen for this work support the notion that political factors do play a significant and positive role on attracting foreign capital towards developing economies when it comes to long term productive investments, represented by FDI inflows. This suggests that FDI is more sensitive to the deterioration of democratic institutions, which may increase the risk of expropriation, corruption, and policy uncertainty, while PCI is more attracted by the potential gains from exploiting arbitrage opportunities, weak regulations, and capital controls.

In addition to this introduction, this work is structured as follows. In section 2, we review of the theoretical and empirical literature for both push-pull framework and "Democracy and Growth", which also includes discussions on how they intersect. In section 3 the database used and an explanation of the method of Local Projections utilized in the estimations of Impulse Response Functions are presented. Section 4 presents the empirical results. Lastly, in section 5 comes the conclusion.

2. Literature Review

2.1 The external "push" and domestic "pull" determinants of capital inflows

The interest in studying the international capital flows rose during the 1990's as a response to its expressive increase seen during the period due to globalization and financial deregulation (Mercado and Park, 2011). Until the consolidation of the push-pull framework, the theoretical benchmark for these studies was the neoclassical growth model, based on the law of diminishing returns to the factors of production. This would result in an intense flow of capital from rich economies to poorer economies, as the latter would be more labor intensive and therefore would grant greater returns to capital. The empirical evidence, however, gave little support to the result expected from the neoclassical model. Although it was observed during the 1990's an increase of capital flow towards poorer and developing economies, many authors pointed out it was in a much lower volume than expected from theory (Ding and Sui, 2021). Lucas (1990) consolidated this inconsistency, coining the notion of

the “allocation puzzle”, also named “Lucas’ paradox”. As a result, the development of theoretical explanations to this phenomenon became a point of interest for economists. Within the neoclassical framework, the explanations were centered on the existence of market imperfections on the international flow of capital, and the consideration of the other factors of production not accounted for in the “labor and capital” growth model (e. g. human capital), as stated by Damasceno (2014).

Contemporary to these discussions, the push-pull framework emerges guided not by any economic theory, but dictated mainly by the empirical studies about the determinants of the international capital flows towards developing economies (Koepke, 2019)[1]. According to this branch of the literature, favorable international conditions such as lower interest rates, higher output growth and lower volatility in advanced economies may push international capital towards developing countries where they usually find both higher risks and returns. Pull factors, on the other hand, represent domestic characteristics of these recipient economies which would attract foreign capital reducing risk or offering higher returns for their investments, such as their own interest and exchange rates, financial openness and economic growth. In short, the focal point of the discussion revolves around the empirical inquiry regarding the dominant factor between push and pull that influences capital inflow towards developing economies. The empirical question at hand seeks to unravel the underlying forces that shape and drive the influx of capital.

The work of Calvo et al (1993) stands out as the starting point of the following empirical research, establishing the push-pull dichotomy. Observing the rise of capital inflows towards Latin America in the beginning of the 1990’s, the authors conclude that this was mainly dictated by a recession in the US economy and low international interest rates, therefore, this trend would be reversed with a change in this favorable global scenario. These results, considering developing economies in general, mean that the capacity to attract foreign capital for these markets would be largely dictated by external factors beyond their range of policies. A similar result was found by Fernandez-Arias (1996), supporting the notion that the global financial market is driven by short-term perspectives, going towards developing countries only in

[1] However, it is possible to establish a link between this literature with models from modern portfolio theory, mainly the works of Markowitz (1952) e and its development for assets in foreign currency in Grubel (1968).

specific contexts when they present themselves as a better risk-return option than advanced economies, easily overturned by changes international conditions (Prates, 1999). However, as the empirical evidence found in Chuhan et al (1993) shows, these results are by no mean a consensus during the initial studies within this framework, as the authors found significance to both push and pull factors, even pointing out the latter as more relevant in Asian developing countries in comparison to Latin America. These examples represent the incipient efforts from this literature to understand the international financial market dynamics, establishing its fundamentals.

From the 2000s onwards, the empirical studies conducted in this field have made remarkable progress due to the utilization of new methodologies and extensive datasets, which have greatly contributed to the comprehension of the subject matter. As an example, with a larger time-span available for analysis, Baek (2006) finds results that reinforce the notion of heterogeneity among developing countries, although for his case the Asian inflow was more pushed in comparison to the more pulled in Latin America. Similarly, Fratzscher (2012) points out that during the 2008 financial crisis, even with international factors being the main drivers of international capital flows, domestic characteristics were relevant for the degree of impact on developing economies during the crisis and in their following recovery. These studies exemplify how this framework not only stayed relevant in the early 2000s and beyond, but also gained more elements of discussion, especially with longer sets of data available for study. A summary of this empirical research can be seen in Table 1 below.

Table 1: Summary of empirical works from the push-pull literature

Author(s)	**Sample**	**Estimation Method**	**Main Results**
Baek (2006)	5 countries from Latin-America and 4 from Asia (1989 – 2002)	Fixed effects	"Push" factors were more prevalent for Asian countries and "pull" for Latin America
Calvo et.al (1993)	10 Latin America countries (1988 – 1991)	Structural VAR	"Push" factors were more prevalent

Chuhan et.al (1993)	9 countries from Latin America and 9 from Asia (1988 – 1992)	GLS and Fixed Effects	Both factors were relevant, especially for the Asian countries
Davis and Zlate (2019)	54 countries including developed and developing economies (1975 – 2015)	Structural VAR	"Pull' factors impact on the effects of "push" factors
Erduman and Kaya (2016)	23 emerging economies from Asia, Europe, Latin America, Africa and Middle East (2005 – 2013)	Bayesian method of Gibbs Sampling	"Pull" factors have limited impact compared to "push" factors
Ferndandez-Arias (1996)	13 middle income developing countries (1989 – 1993)	OLS	"Push" factors were more prevalent
Fratzscher (2012)	50 emerging and developing countries (2005 – 2010)	OLS	"Push" factors were more prevalent
Gossel and Biepke (2017)	South Africa (1986 – 2013)	VECM	"Push" factors are more relevant for FDI on the short-term, but "pull" factors have more impact on the long-run
Ibarra and Tellez-Leon (2020)	Mexico (1995 -2015)	VAR	"Push" factors are less relevant for FDI in comparison to portfolio investment.
Kim and Kang (2019)	47 developed and developing economies (1997 – 2015)	OLS	"Push" factors were more prevalent but with regional specificities
Sarno et al (2015)	55 countries grouped by region (Europe, North America, Latin America, Africa and Asia and Oceania) (1988 – 2013)	Bayesian method MCMC (Monte-Carlo Markov Chain)	"Push" factors were more prevalent
Weiss and Prates (2017)	42 developing countries (1990 – 2008)	GMM	"Push" factors were more prevalent

Source: By the author

Among these examples one can point out important results for the current understanding of the dynamics of international capital towards developing economies within the push-pull framework. As previously stated, from the offset of this literature

there were studies that shown how there were regional differences between developing countries that altered the dynamics of push and pull factors. The result seen in Gossel and Biepke (2017) discuss how differences may also be seen in time, that is, foreign capital might be pushed on the short term but pulled in the long run. Also, the discussion present in Ibarra and Tellez-Leon (2020) leads to understand that there are also differences in response to push and pull factor for different profiles of international capital.

These results illustrate how the question regarding the dominant factor between push and pull requires more investigation beyond the push and pull determinants established in the existing empirical research on this topic[2]. This notion is the reason why this work aims to explore, within the push-pull framework, how political and institutional factors may play a role on attracting international capital towards developing economies, as these may be one of the underlying reasons that explain how countries with similar economic profiles can differ in ability on attracting foreign capital.

In this spirit, a succinct discussion of the interplay between democracy, political institutions and economic development is provided in the following section.

2.2 On democracy, political institutions, and economic development

The study about the relationship between democracy and economic development gained relevance during the 1990's stemming from a critique of the neoclassical models. Centered on the returns of the factors of production, this framework proposes that economic growth is determined on the long-run by its rate of technological progress (Solow 1957), a variable understood as exogenous to the model. Naturally, the lack of explanation about this parameter led to theoretical proposals which could overcome such limitation, leading to the development of endogenous growth models. The work from Romer (1986) was the basis for the proposition of alternatives to the neoclassical framework, treating long-run growth as driven by externalities from elements within the economies, such as human capital, expenditure in public

[2] As Weiss and Prates (2017) point out, most works within this framework use as *"*Push*"* factors the mainly the US interest rate, the growth rate of the main world economies and indexes for market volatility, for *"*Pull*"* factors are usually considered indicator of macroeconomic stability and also domestic assets return rates.

infrastructure and institutional quality (Ghardalhou and Sridi, 2019). The last group of models used the definition proposed by North (1991) of institutions as the formal and informal rules that guide economic, political, and social interactions. As pointed out by North (1994), the political aspects of institutional arrangements have an important role in economic development by establishing the rules it must follow.

This notion led to the consolidation of the New Institutional Economy (Colagrossi et al, 2020), a field of study focused on understanding the interaction between political factors on economic growth and development. Largely, the empirical research analyzed how the existence of democratic regimes impacted on growth dynamics. As shown in Sirowy and Inkeles (1990), this is a debate that precedes the New Institutional Economy, having theoretical arguments for democratic regimes, as both compatible or as in contrast to economic development. Therefore, the studies from this literature are dedicated to evaluate if democracies are capable of producing positive impacts on growth, reducing political instability and ensuring property rights or rather their liquid effects are negative due to being subjected to popular demands, having to oblige to short-term decisions in detriment of the long-run (Doucouliagos and Ulubasoglu, 2008).

As for the empirical studies, it is important to mention how the first efforts were directly influenced by the findings of the important role of institutional quality on economic growth in Barro (1991) and Sala-I-Martin (1997). Already during the 1990's, one can observe works dedicated to the effects of democracy on economic development, with results favorable to both points of view. As an example, both Rodrick (1997) and Alesina et al (1996) find no statistical difference in growth between democratic and authoritarian countries. However, the former author points out how democracies produce more stable growth trajectories, while the latter arguments are that these regimes can aid on economic development by reducing political instability. In Barro (1996), the positive effects of democracy are seen mainly in countries with low indexes of political liberties; this relation diminishes as these indexes grow, even becoming negative in some cases.

These examples represent the consolidation of the interaction between economic growth and democratic regimes as a relevant object of study for empirical works from the following decades. Despite theoretical arguments and early empirical results,

some authors were able to find a consistent positive effect of democracies on long-run economic growth, as seen in Acemoglu et al (2014) and Gerrig et al (2005). Moreover, the discussion in Mathonnat and Minea (2019) focuses on how different democratic regimes have specifical institutional arrangements, which in turn are essential to understand the impact of these democracies on growth dynamics. This notion allows us to understand how works such as Knutsen (2012), Peev and Mueller (2012) and Rachdi and Saidi (2014), in dealing with different democracies may find results that at first glance may contradict each other.

These results show the importance of understanding how the many institutional arrangements possible within a democratic government can affect economic growth in different manners. As mentioned, one of the many explored aspects in the literature lies on how democratic regimes may reduce political instability, which in turn elevates growth; these results are found also in Aisen and Veiga (2012) and Jong-A-Ping (2008). Additionally, Cox and Weigast (2018) discuss mainly about the important role governmental accountability plays in fomenting economic growth.

A summary of this empirical literature can be found in Table 2 below:

Table 2: Summary of empirical works from the Democracy and Economic Development

Author(s)	**Sample**	**Estimation Method**	**Main Results**
Acemoglu et al (2014)	Group of 175 countries (1960 – 2010)	Fixed Effects and GMM	Democratic regimes produce long-run positive effects on growth
Aisen and Veiga (2012)	Group of 169 countries (1960 – 2004)	GMM	Political stability has a greater positive effect on growth compared to the existence of a democratic regime
Alesina et al (1996)	Group of 113 countries (1950 – 1982)	GLS	Political stability has a greater positive effect on growth compared to the existence of a democratic regime
Barro (1996)	Group of 100 countries (1960 – 1990)	Instrumental Variables	Strengthening of Democratic regimes produces positive effects on growth specially for countries with low political liberty

Cox and Weingast (2018)	Group of 65 countries (1850 – 2005)	Difference-in-difference estimation	Governmental accountability produces positive effect on economic growth
Gerrig et al (2005)	US, Chile, Botswana and China (1950 – 2000)	Fixed Effects	Democratic regimes produce long-run positive effects on growth
Jong-A-Ping (2008)	Group of 90 countries (1974 – 2003)	GMM	Political stability has a positive effect on growth
Knutsen (2012)	Group of 112 countries (1984 – 2004)	OLS, Fixed Effects and GMM	Democracies had greater growth compared to non-democracies on Sub-Saharan Africa
Mathonat and Minea (2019)	Group of 140 countries (1975 – 2007)	Random Effects	Different democratic arranges produce distinct growth trajectories
Peev and Mueller (2012)	24 transition economies from Eastern Europe (1994 – 2009)	Fixed Effects	Inconclusive liquid effect of democracies on growth in transition economies
Rachdi and Saidi (2014)	17 countries from the Middle East and Northern Africa (1983 – 2012)	Fixed and Random Effects and GMM	Democratic regimes produced negative effects on Growth
Rodrick (1997)	Group of 80 countries (1970 – 1994)	GLS, Fixed Effects and Random Effects	Democratic countries had more stable growth trajectories although not better than non-democracies

Source: By the author

Next, the focus of analysis will be on the discussions regarding the relationship between democratic institutions and capital flows.

2.3 Democracy and Capital Flows

Within the context of the New Institutional Economy, as some works have shown, democracies have also been associated with a greater capacity to attract foreign investment, which in turn leads to economic growth. As Alfaro et. al. (2007) points out, institutional quality also represents a measure of country risk, therefore, following the rationale of a foreign investor within the context of portfolio theory, a country with stable and functional democratic institutions reduces the expected risk

for their capital, making it a more desirable destination. Likewise, as good institutions promote economic development they also, indirectly, foster a better environment for attracting international capital. For these reasons that some studies found both direct and indirect impacts of democratic regimes on capital inflow (e. g. Gossel, 2018; Jakobsen and Soysa, 2006; Busse, 2003; Malikane and Chitambara, 2017; Sabir et al 2019).

One must point out though, that these empirical works were not made with the push-pull framework in mind, as they were focused on the interaction between democratic institutions and capital inflow, largely disregarding for how push and pull factor would interact with this dynamic. Some research has been made along those lines, such as seen in Cavallaro and Cutrini (2019), where the authors find institutional quality as an important factor to reduce the vulnerability of developing markets' capital inflow to external shocks. Asongu et al (2018) also explores this idea but points out how pull factors, other than institutional quality, are better suited to explain the flow of FDI to BRICS (Brazil, Russia, India, China and South Africa) and MINT (Mexico, Indonesia, Nigeria and Turkey) countries. Examples like these however are rarer within the context of the push-pull dichotomy, and in general lack the depth present in the previously mentioned studies, such as dissecting institutional quality in more specific arrangements.

Table 3: Summary of empirical works on the relationship between Democracy and Capital Flows

Author(s)	**Sample**	**Estimation Method**	**Main Results**
Alfaro et. al. (2007)	23 developing countries (1970 – 2000)	OLS	Improvements on institutional quality promote foreign capital inflows.
Asongu et al (2018)	Brazil, Russia, India, China, South Africa, Mexico, Indonesia, Nigeria and Turkey (2001 – 2011)	OLS and Fixed effects	For the selected countries the main "pull" factors for FDI were the size of the economy, existing infrastructure and commercial openness
Busse (2003)	69 developing countries (1972 – 1999)	Fixed Effects	Democratic regimes attract FDI

Cavallaro and Cutrini (2019)	9 developed economies and 28 emerging economies from Latin America, Asia and Europe. (2005 – 2014)	Fixed Effects	Institutional quality presents itself as relevant for protecting against adverse external shocks on capital inflow
Gossel (2018)	30 countries from Sub-Saharan Africa (1985 – 2014)	GMM	Democratic regimes attract FDI
Jakobsen and Soysa (2006)	Group of 98 countries (1984 – 2001)	Panel-Corrected-Standard-Errors (PCSE)	Democratic regimes attract FDI
Malikane and Chitambara (2017)	Group of 8 Southern Africa countries (1980 – 2014)	GMM	Better democratic institutions lead do greater effects of FDI on growth
Sabir et al (2019)	Group of 148 countries (1996 – 2016)	Fixed Effects and GMM	Democratic regimes attract FDI

Source: By the author

Table 3 above summarizes the main concern for this work. As the empirical research from the New Institutional Economy intersects with the topics from the push-pull framework it does so in disregard of the discussion and developments from the latter about the dynamics of international capital towards developing economies. As for the studies from the push-pull literature, they largely do not take into account the contributions that New Institutional Economy's research has provided about the complexity of how democratic institutions interact with economic factors. The examples above also focus largely on FDI inflow, which as seen in this literature review has a particular interaction with pull factors that differs from other profiles of international capital, which may have their own response to improvements on institutional quality.

For these reasons that this research aims to reinforce the link between the push-pull framework with the studies about the effects of democracies and democratic institutions on economic growth widely discussed in the New Institutional Economy literature. It is expected that the analysis proposed in this work may contribute to both literatures, reinforcing the importance of studying them in tandem.

2.4 Democracy and Capital Flows: Establishing Links

As the final portion of this literature review the focus will now shift away from the empirical research to explore the mechanisms through which democratic institutions may affect foreign capital inflow towards developing economies. As will be detailed in the following section this discussion will center around how these institutions may attract both FDI and PCI. The following hypotheses summarize the theorical beliefs surrounding this dynamic.

Hypothesis 1.1: *Improvements in the quality of democratic institutions can lead to an increase in Foreign Direct Investment.*

As aforementioned, democratic institutions play a role in attracting foreign capital since their quality represents a measure of country risk premium for international investors. For the case of FDI, according to the literature, democracies possess a better system of checks and balance of governmental power, this results in a strengthening in property rights, securing investments for the long haul, and greater stability in policymaking, resulting in a more predictable environment for foreign investment (Li et al, 2018). Additionally, democratic governments also tend to have freer media, which allows for better assessment of governmental action, granting investors the ability to better assess rather the policymaking is favorable for FDI (Choi and Samy, 2008). Lastly, as discussed in detail, democracies are also associated to better and more stable economic growth, this alone is an important driver for international capital inflow.

Hypothesis 1.2: *Improvements in the quality of democratic institutions can reduce Foreign Direct Investment.*

In contrast, democratic countries might be a less desirable destiny for FDI especially for being more susceptible to cave to popular demand. Less concerned with voters' pressure, Authoritarian governments are more capable to protect foreign investors from workers' demands of higher wages and legal protection, and from less capital friendly taxation (Li and Resnick, 2003). They may also offer less legal resistance to international firms in the extractive industry or those highly depend of natural resources (Asiedo and Lien, 2011). It is for those reasons that there is some

uncertainty on the net effect of democratic institutions on FDI inflow towards developing countries, justifying the interest on this research agenda.

Hypothesis 2.1: *Improvements in the quality of democratic institutions can lead to an increase in Portfolio Capital Inflow.*

Likewise, PCI presents itself as an important object of study. Despite its distinct nature from FDI, it similarly benefits from the positive effects democratic governments have on economic performance and stability. Additionally, transitions towards democratic governments are strongly, although not necessarily, associated with increase in economic freedoms, exemplified with varying degrees in the case of the former Soviet Union countries (Peev and Mueller, 2012). As liberalization grows, the more attractive the economy becomes to the more volatile and speculative profile of capital represented by foreign portfolio investment.

Hypothesis 2.2: *Improvements in the quality of democratic institutions can reduce Portfolio Capital Inflow.*

As a profile of foreign investment strategy with a focus on short-term gains, PCI is less affected by institutional quality, having a stronger response to changes in fiscal policies (Ahlquist, 2006). This means that, although attracted by how democratic governments improve economic performance and promote more stable environments for international investment, PCI might have a greater negative response to democracies' possibility to a governmental shift towards less capital friendly fiscal policies and taxation.

Thus, this section has explored the transmission channels through which changes in democratic institutions may have an impact on capital inflows towards developing economies. For this study it is mainly expected to be found evidence that support Hypothesis1.1. Following this discussion will be the presentation of the data set and empirical technique used in this study.

3. Data and methodology

This section will present the dataset, the empirical model, and the estimation method used for this study. It starts with the estimation method, which is Local Projection, a

distinctive feature of this research that sets it apart from other empirical studies in the push-pull framework.

3.1 Local projections

For this empirical analysis, the method of Local Projection for generating Impulse Response Functions was chosen with two reasons in mind. First, as Table 1 exemplifies, most empirical research in the push-pull framework uses either traditional methods of linear regression for panel data (Pooled OLS, Fixed Effects, Random Effects or GMM) or generates Impulse Response Functions through VAR modeling. Therefore, this study aims to present the method of Local Projection as an analytical alternative for future research. The second reason, comes from the fact that, as aforementioned, democratic backsliding is a gradual process. Therefore, the response of international stakeholders to changes in the political landscape may occur with a lag, as they perceive, process, and adjust their investment strategies accordingly. By generating Impulse Response Functions, the Local Projections technique allows us to observe the possible effects of changes in democratic institutions on foreign capital inflow through time.

The following presentation of the method of Local Projections is based on Adämer (2019). A more detailed explanation about this method and how it differs from VAR estimation can be found in Appendix A.

The method of Local Projections, as proposed in Jordà (2005) is an alternative approach to estimate impulse response functions. The method for panel data consists of OLS regressions with robust standard errors using the approach by Newey and West (1987) for each forecast horizon of the following equation:

$$F_{i,t+h} - F_{i,t-1} = \alpha^{i,h} + \beta_h P_{i,t} + \gamma_h X_{i,t} + \varepsilon_{i,t+h},\ h = 0,1,\ldots,H-1, \qquad (1.1)$$

where, in the case of this study, F_{it} represents the measurement of capital inflow for country *i* on year *t;* P_{it} is the shock variable which accounts for the domestic political variable being analyzed; $X_{i,t} = \{E_t; D_{i,t}\}$ account for the controls wherein E_t represents a vector of (external) push factors, common to all economies each year, and $D_{i,t}$ is the vector of economic (domestic) pull factors for each country. The cumulative impulse response functions are estimated using the difference between

lagged $F_{i,t}$ and each forecast horizon as the endogenous variable. The coefficient β_h corresponds to the deviation of $F_{i,t}$ at time $t + h$ with respect to $F_{i,t}$ at time $t -1$ to the shock variable $P_{i,t}$ at time t. The impulse responses are the sequence of all estimated β_h.

The next section will detail the dataset of the following empirical exercise.

3.2 Data and Econometric model

Aiming to examine how capital inflow towards developing economies is impacted by their domestic political and democratic factors, the dataset used in this study contains yearly data from 31 countries classified by the IMF as emerging market economies from 2000 to 2020, the full list can be found in Appendix B. As it will be discussed in more detail along this section, the choice of variables was made according to the standard from the empirical research within the push-pull framework, with the addition of the proposed political indicators.

For measuring capital inflow towards developing economies, it was used data from the Financial Account of the Balance of Payments available through the IMF. In the light of the results found in Gossel and Biepke (2017) and Ibarra and Tellez-Leon (2020), the choice was to use the net inflow of foreign owned FDI and PCI towards developing economies. Both these variables are used separately as the dependent variable of the econometric model. This distinction is relevant for this analysis as FDI, due to its long-term nature[3] (IMF, 2009), will be treated as a representation of productive investment; in contrast, PCI will be seen as a proxy for speculative investment likewise, due to its more highly negotiable nature. This will allow to understand how these profiles of capital inflow differ in response to political changes in the recipient countries.

For the independent variables, the first set represents the international "push" factors common across all countries. It was used the US interest rate, world GDP growth and VIX index. Respectively, these variables represent the competing rate against

[3] From the BPM6 "Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy." and "Because there is control or a significant degree of influence, direct investment tends to have different motivations and to behave in different ways from other forms of investment.(…) Direct investment tends to involve a lasting relationship(…)"

international investment in developing economies, level of international economic activity and risk of international investment. The second group represents domestic "pull" factors, GDP growth rate, real interest rate and share of public debt by GDP, representing favorable returns for capital inflow towards developing economies and their risk factors.

Lastly, a set of "Political-Institutional Pull factors". Those were chosen from the V-Dem Project (Pemstein et al, 2022), a database with consolidated methodology for measuring democratic indexes worldwide. The full choice of variables can be seen on Table 4, but in general, the selection of these political factors was made with their direct and indirect effects on capital inflow in mind, and also, aiming to, collectively, represent different measurements of democratic quality. A general index for democratic quality was also included as a starting point for discussion. As will be explained further, the effects from these indexes on capital inflow will be valuable for the analysis, both individually and as a group, allowing an evaluation of the relation between democratic governments and capital inflows.

Table 4: List of variables from the dataset

Variables	**Classification**	**Description**	**Source**
FDI	Dependent	Net inflow of foreign owned Foreign Direct Investment in millions of dollars (constant)	IMF - Balance of Payments
PCI	Dependent	Net inflow of foreign owned Portfolio investment in millions of dollars (constant)	IMF - Balance of Payments
RIR	Domestic	Domestic Real Interest Rate	World Bank - World Development Indicators
GDPg	Domestic	Domestic GDP growth rate	IMF - World Economic Outlook
Debt	Domestic	Share of public Debt by GDP	IMF - World Economic Outlook
LibDem	Domestic	General index for quality of Liberal Democracy. Higher values indicate better institutional quality	V-DEM
Client	Domestic	Index of how much politics is based on clientelistic relationships. Lower values indicate better institutional quality.	V-Dem

RoL	Domestic	Index of how effective and equalitarian is law enforcement. Higher values indicate better institutional quality.	V-Dem
FreFair	Domestic	Index measuring electoral fairness and freedom. Higher values indicate better institutional quality.	V-Dem
HorAcc	Domestic	Index measuring horizontal accountability of ruling government. Higher values indicate better institutional quality.	V-Dem
GenPp	Domestic	Index of female participation in politics. Higher values indicate better institutional quality.	V-Dem
Inst	Domestic	Political instability Index. Lower values indicate a more stable political scenario.	World bank Governance indicators in V-Dem
VIX	External	Yearly mean VIX index	Chicago Bord Options Exchange
GDPgW	External	World GDP growth rate	IMF - World Economic Outlook
RIRUs	External	US Real interest rate	IMF - Balance of Payments

Source: By the author

Table 5: Summary statistics of variables from the dataset

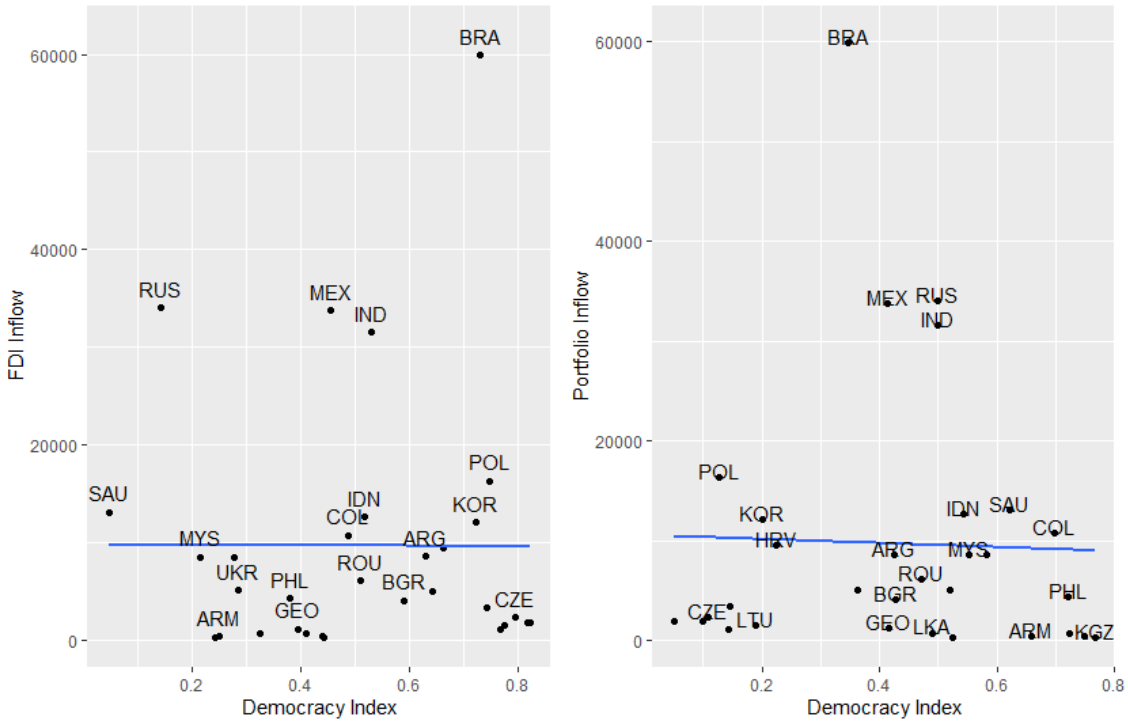
Variables	**Mean**	**Median**	**Stand. Error**	**Minimum**	**Maximum**	**Missing Obs.**
FDI	9,668.21	3,594.55	15,893.21	-6,839.04	117,851.02	0
PCI	4,447.74	712.96	11,645.47	-33,557.80	85,039.53	3
RIR	7.54	5.25	10.08	-12.86	93.92	150
GDPg	3.47	3.96	4.09	-15.10	14.81	0
Debt	43.38	40.05	22.24	1.54	147.20	0
LibDem	0.51	0.52	0.22	0.04	0.85	0
Client	0.43	0.45	0.22	0.04	0.86	0
RoL	0.77	0.81	0.18	0.15	0.98	0
FreFair	0.68	0.75	0.27	0.00	0.97	0
HorAcc	0.72	0.85	0.70	-1.08	2.04	0
GenPp	0.84	0.89	0.16	0.06	1.00	3
Inst	-0.17	-0.13	0.79	-2.37	1.30	31

VIX	19.95	17.54	6.50	11.09	32.70	0
GDPgW	3.48	3.55	1.94	-2.81	5.57	0
RIRUs	2.83	2.44	1.46	1.14	6.84	0

Source: By the author

As an illustration of the data base and a precursor to the econometric modeling, Figure 1 shows the scatter plot of the average capital inflow for each country in the data base against their average democracy index. Although the plot for FDI shows no correlation between those variables, a positive correlation is seen for Portfolio Investment.

Figure 1: Average FDI (left) and PCI (Right) against the average Liberal Democracy Index for each country.



Source: By the author

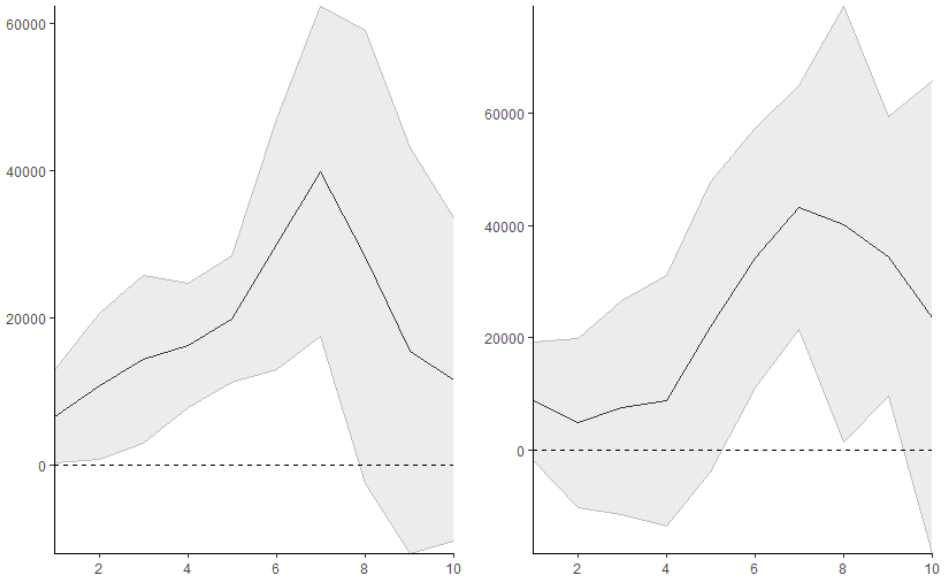
A simple correlation analysis presented in Figure 1 shows an intriguing result by suggesting the absence of a relationship between democracy and FDI and PCI. However, the correlation analysis does not allow us to separate the confounding factors, nor to capture the dynamic effects of the relationship between these variables. For this, we will proceed to the estimation of the econometric model.

4. Results

This section will present the results from the Impulse Response functions estimated using local projections, the tables of estimated coefficients can be found in Appendix C. For each political variable it will be made a comparison between its effect on net inflow of both FDI and PCI. Understanding that political factors generally have greater impact on the long run rather than the short term, it is expected that they will be more impactful on the flow of FDI following results found in other empirical works, which is seen below.

Starting with the more general index for Liberal Democracy, Figure 2 presents the expected result in which, for both measures of capital inflow, this index has in general a positive and significant effect.

Figure 2: Impulse Response Functions of shocks in Liberal Democracy index in FDI (Left) and PCI (Right).



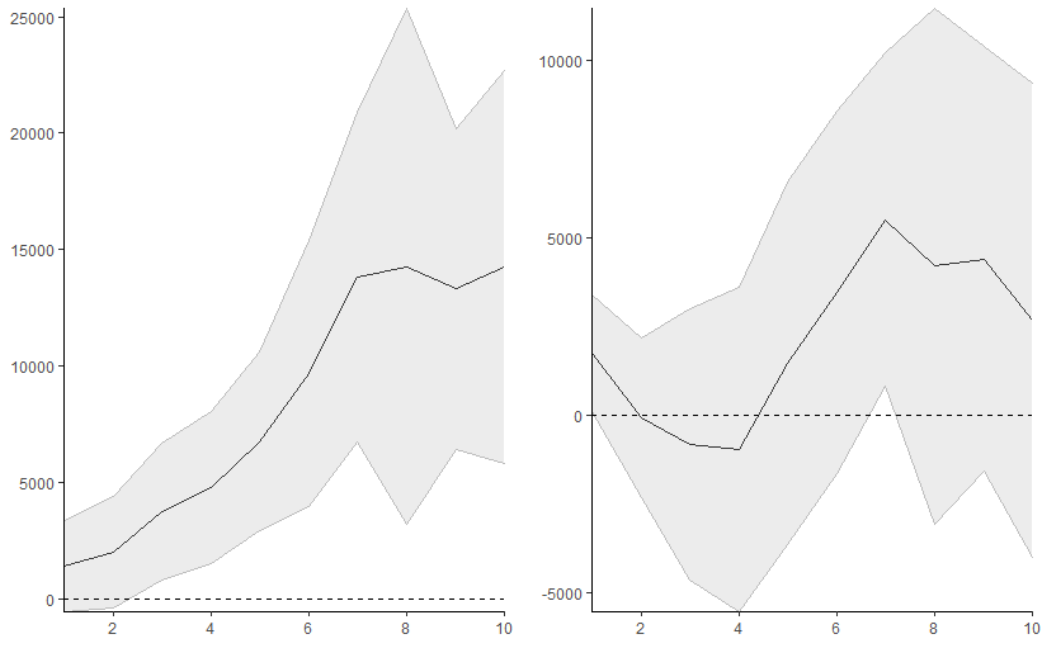
Source: By the author

Although the results presented in Figure 2 corroborate Hypotheses 1.1 and 2.1, suggesting a positive correlation between Liberal Democracy and both FDI and PCI, this may obscure the nuanced responses of FDI and PCI to variations in the quality of specific aspects and institutions constituting democratic regimes. Therefore, a

comprehensive analysis is warranted to explore how FDI and PCI are influenced by the quality of various fundamental components of democratic systems.

This then leads to the following analysis, focused on Horizontal Accountability, where it is expected that this variable would have a positive impact on capital inflow towards developing economies. The rationale being that, as a mechanism of control, a higher index of accountability results in less erratic governmental decisions and expenditure, making foreign investment less risky therefore incentivizing it, as previously discussed. Figure 3, shows that this result is clearly observed for FDI, but for PCI little statistical significance is found for most of the forecast horizons. Although one could expect Portfolio Investment would also benefit from a less arbitrary governmental decision-making process, these results may align with the hypothesis that these investors focus more on economic performance, being less concerned on political nuances, therefore having little response to these changes.

Figure 3: Impulse Response Functions of shocks in Horizontal Accountability in FDI (Left) and PCI (Right).

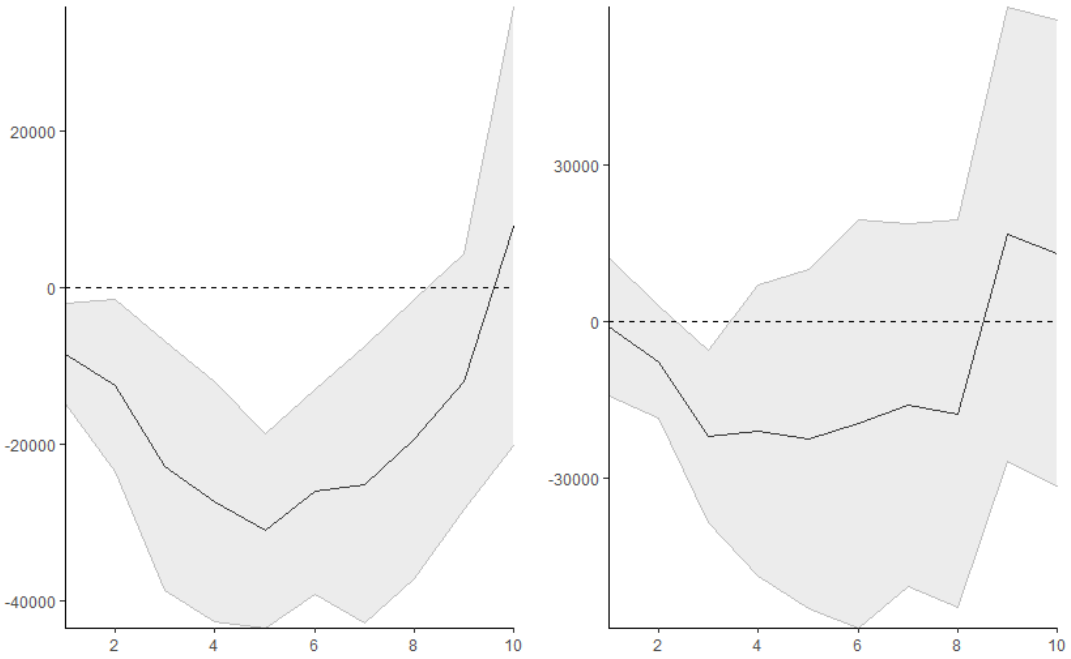


Source: By the author

Moving on to the index of Clientelism, it is important to point out that, in contrast with the previous index, the higher the clientelism index, the worst the level of institutional quality. Regarding how clientelistic relationships in politics may lead to

inefficient policymaking, one can expect it would make a country less attractive for foreign capital as it can make their investment riskier or less profitable. Once again, the Impulse Response Functions shows that this relation, however, occurs more strongly for FDI inflow as seen in Figure 4. The repetition of this pattern in both Figure 4 and 3 reinforces the main expected result of this work, with FDI holding a stronger tie with democratic institutions than portfolio investment, something also seen in other empirical research.

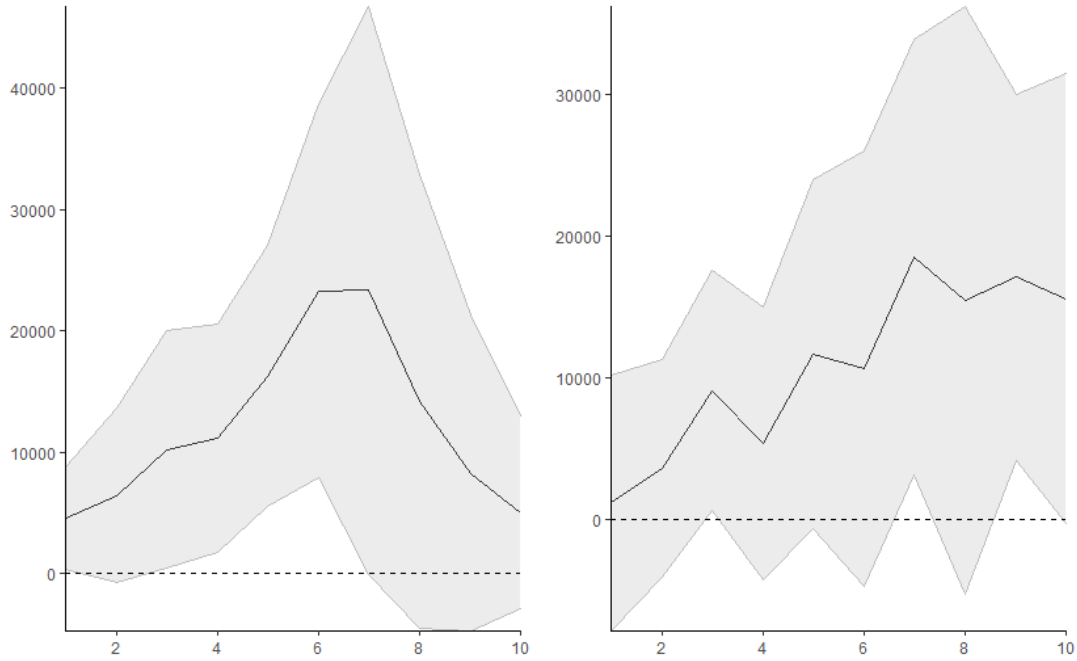
Figure 4: Impulse Response Functions of shocks in Clientelism in FDI (Left) and PCI (Right).



Source: By the author

The next set of graphs seen on Figure 5 and Figure 6 also allows some observations. Starting with the index of Free and Fair Elections, its increase represents a strengthening of democracy, thus leading to greater political stability as elections are not contested. As expected, this index has a positive impact on FDI inflow, albeit seen only for some forecast horizons, which indicates its affinity with solid democratic institutions. For the case of PCI, however, the results are more inconclusive, reinforcing the idea expressed in Hypothesis 2.2 in which the positive impacts from good democratic institutions may be counterbalanced by the risk from governmental shifts caused by electoral outcomes, leading to no significant impact.

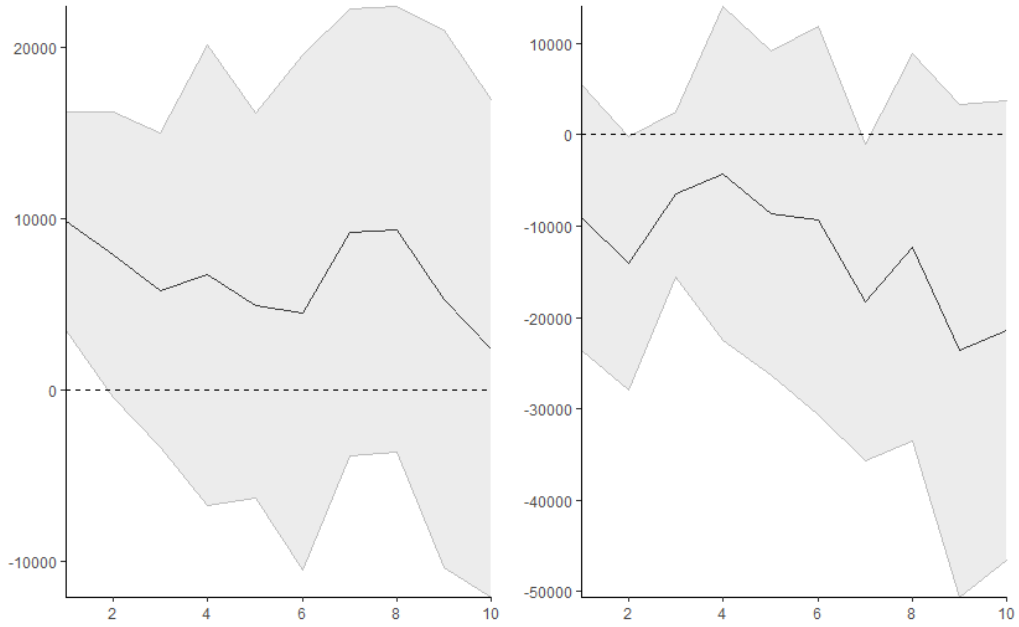
Figure 5: Impulse Response Functions of shocks in Free and Fair elections in FDI (Left) and PCI (Right).



Source: By the author

The case for the index for Female Participation in Politics is less straightforward as it impacts capital inflow through indirect means. This index may account for the quality in civil rights and is also associated with less corrupt governments (Swamy et. al 2000; Forgues-Puccio and Erven Lauw, 2021), both impacting somewhat on a country's attractiveness to foreign capital. As Figure 6 shows, however, this index's impact on capital inflow might not be as strongly associated with capital inflow as for both FDI and PCI its results were mostly not significant, albeit some positive effect is seen for the case of FDI. As stated, in being a index with a more indirect effect, this is not a surprising result and neither does it speak against the main hypothesis of this work, as some indexes are expected to have no statistical impact. Moreover, Figure 6 allows to point out how, while some positive effect was seen for FDI it does not happen for PCI, which on itself is a important result.

Figure 6: Impulse Response Functions of shocks in Female Political Participation in FDI (Left) and PCI (Right).

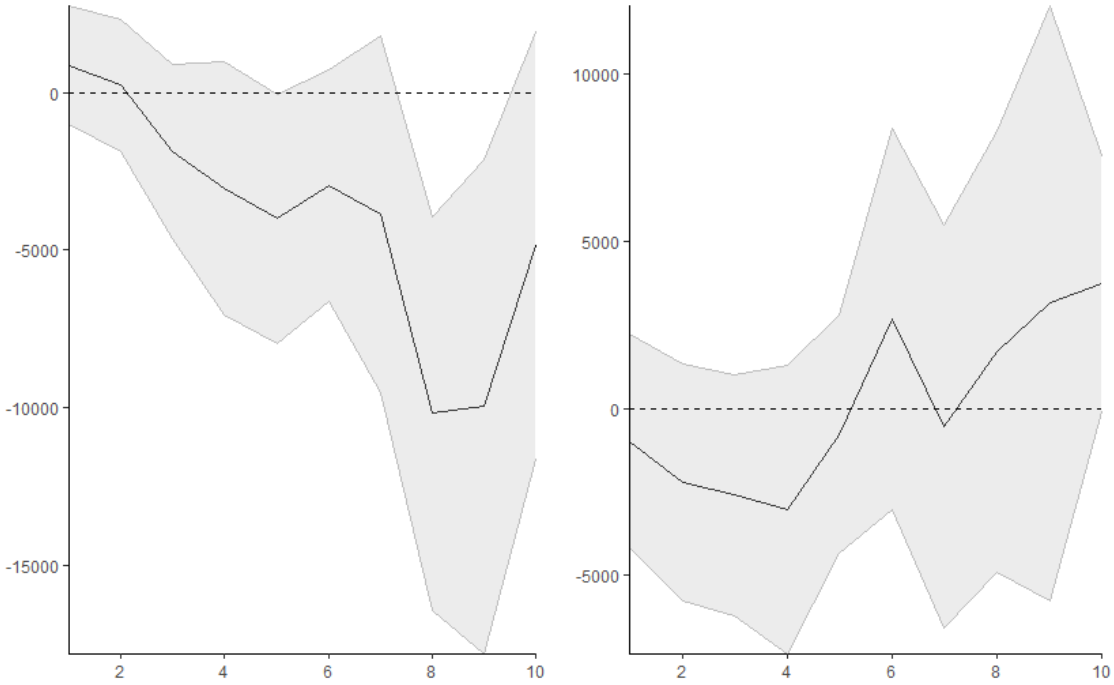


Source: By the author

Next, like the Clientelism index, the Political Instability index has higher values associated to worst institutional quality. It is also expected to hold a negative impact on capital inflow towards developing economies, as it not only represents a more elevated country risk factor, but also because political turmoil is associated with worse economic performance as shown in the literature review.

This reasoning explains how on Figure 7 it is seen how political instability produces a negative impact on FDI inflow, although, unexpectedly, not for most of the forecast horizons. Also as a surprise, for PCI the effect is largely not statistically significant, which may indicate that the mechanism through which political instability impacts capital inflow may not be as certain as expected, discussing this point in depth however goes beyond the main goal of this current empirical study.

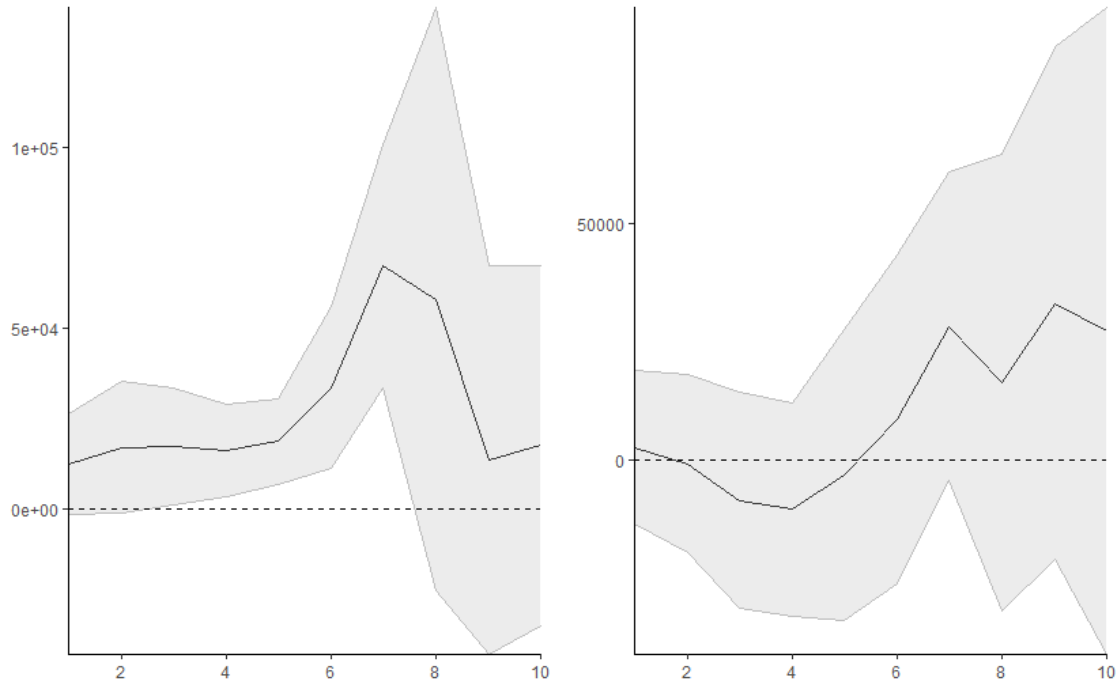
Figure 7: Impulse Response Functions of shocks in Political Instability in FDI (Left) and PCI (Right).



Source: By the author

Lastly, the index of Rule of Law indicates institutional quality regarding the law enforcements and access to rights. Regarding foreign capital, this indicator represents a better guarantee of protection of the investment according to domestic laws, especially for the case of productive capital. With this in mind, there is no surprise how it has a positive effect on FDI inflow as seen in Figure 8. As was mostly the case for other political variables, PCI was also not affected by this index adding to the conclusions regarding by how this profile of capital little interacts with politics.

Figure 8: Impulse Response Functions of shocks in Rule of Law in FDI (Left) and PCI (Right).



Source: By the author

In general, these results support the hypothesis that political factors are relevant for pulling foreign capital toward developing economies. The findings suggest that the inflow of international productive investment, measured through the FDI inflow, is positively associated with a better quality of democratic institutions. Conversely, although the main democracy index had a positive impact on PCI inflow, in examining the more specific mechanisms little support was found to this association. These results seem to reinforce how, for this profile of capital inflow there is not a clear response to better democratic institutions.

In a summary, the results support the belief that while FDI is attracted by better regulated environments with solid democratic institutions, while PCI seems to disregard this aspect. This implies that, as countries adopt policies that strengthen their democratic arrangements, they may impact their composition of foreign capital inflow towards a less volatile profile, with greater interest in the long run. This in turn alleviates the constraints imposed by the risk of short-term downturns in foreign capital inflow over domestic policy making from incumbent governments (Bordo and James, 2015). Moreover, as initially discussed, the results shown also indicate that

through the process of democratic backsliding, developing countries may also be augmenting their exposure to international financial crisis as they would lose attractiveness to stable and long-term foreign investment, beyond the social and political effects this process has.

There is a vast literature showing how the international financial market can impose a market-friendly agenda on developing countries, thus reducing their policy space and their ability to conduct social and redistributive policies with the aim of meeting the voters' demands and electoral promises (Campello 2009;2015). This impact is accentuated by the fact that international financial markets have a more consistent and coherent policy agenda than the diverse and conflicting preferences of voters. This makes the markets more influential and persuasive in achieving their goals (Karwowski, 2019; Crouch, 2016). The increasing inability of policymakers to meet voters' demands is seen as a key cause to the recent rise of populist, and, often authoritarian governments in western democracies (Crouch, 2019). Those, in turn, under the banner of representing popular demand, will often undermine democratic institutions as part of their political agenda.

The results and arguments suggest that stable foreign capital inflows prefer good democratic institutions, which can also enhance and safeguard the quality of these institutions. Conversely, volatile foreign capital inflows can harm the economy as well as the institutional quality of the receiving countries, both directly and indirectly.

5. Conclusion

The aim of this work was first to establish a link between two consolidated economic literatures, those being the push-pull framework and New Institutional Economy study of democracy and economic growth. This objective was successfully accomplished, both in exploring how these literatures stemmed from critiques of the neoclassical model, and by analyzing variables often used in the latter within the structure of empirical works of the former.

A second objective, in finding support of how these political variables affect capital inflows was also accomplished. As expected from other empirical studies, FDI, due to its nature more associated with the long term in comparison with PCI, showed significant and positive responses to better institutional quality. Further research may

explore this result in depth associating to a larger array of variables and other good metrics for democratic quality.

Lastly, it was of great interest to be able to also discuss, the interplay between politics and international capital inflow towards developing economies. As briefly discussed, the results from this empirical work indicate that as some countries go through the process in democratic backslide it may also result in a shift towards a more volatile foreign capital inflow, making their economies more exposed to negative impacts from international financial crises. Moreover, the evidence suggests that, on the interest on promoting a stable inflow of foreign capital, developing economies may pursue policies that strengthen their democratic institutions.

Some limitations of this research worth to point out is that the choice of years available for the data base was dictated by the availability of information, especially concerning political indexes, therefore is a limitation that can be dealt with in repetition of this empirical work through time. Also, as the aim of this study was to assess rather political factors impact capital inflow towards developing economies there was no interest in discuss how these results may differ according to the chosen methodology, being also a possible research agenda.

In summary, the discussion and results from this research show how the push-pull framework can benefit from incorporating discussions present in the political economy, as much as it may also be a useful tool in understanding the dynamics between international market of capitals and domestic politics.

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APENDIX

A- VAR and Local Projections

From Adämer (2019):

A Structural VAR (SVAR) with n variables can be written as:

$$\begin{pmatrix} \beta_{11}^0 & \cdots & \beta_{1n}^0 \\ \vdots & \ddots & \vdots \\ \beta_{n1}^0 & \cdots & \beta_{nn}^0 \end{pmatrix} \begin{pmatrix} y_1 \\ \vdots \\ y_n \end{pmatrix} = \begin{pmatrix} \alpha_1 \\ \vdots \\ \alpha_n \end{pmatrix} + \begin{pmatrix} \beta_{11}^1 & \cdots & \beta_{1n}^1 \\ \vdots & \ddots & \vdots \\ \beta_{n1}^1 & \cdots & \beta_{nn}^1 \end{pmatrix} \begin{pmatrix} y_1 \\ \vdots \\ y_n \end{pmatrix}_{t-1} + \ldots + \begin{pmatrix} \beta_{11}^p & \cdots & \beta_{1n}^p \\ \vdots & \ddots & \vdots \\ \beta_{n1}^p & \cdots & \beta_{nn}^p \end{pmatrix} \begin{pmatrix} y_1 \\ \vdots \\ y_n \end{pmatrix}_{t-p} + \begin{pmatrix} \varepsilon_1 \\ \vdots \\ \varepsilon_n \end{pmatrix}_t \quad \text{(A.1)}$$

Which can be written as:

$$B_0 Y_t = \alpha_t + B(L) Y_t + \varepsilon_t \quad \text{(A.2)}$$

The residuals ε_t are assumed to be white noise with zero mean. This representation results in structural shocks being contemporaneously uncorrelated, and the variables in Y_t having effects on each other in t. This effect is measured by the square matrix B_0. Estimating this, SVAR however requires further assumptions, as it is not possible to estimate the system because of simultaneous identification problem even by assuming orthogonality of the structural shocks.

The SVAR in reduced form (henceforth VAR) is written as:

$$Y_t = \tilde{\alpha} + \tilde{B}(L) Y_t + u_t \quad \text{(A.3)}$$

Where:

$$\tilde{\alpha}_t = {B_0}^{-1} \alpha, \tilde{B}(L) = {B_0}^{-1} B(L) \quad \text{(A.4)}$$

And

$$E[u_t u'_\tau] = \{(\sigma_1^2 \ \ldots \ \sigma_{1n}^2 \ \vdots \ddots \vdots \ \sigma_{n1}^2 \ \ldots \ \sigma_n^2), for\ t = \tau\ 0, else. \quad \text{(A.5)}$$

The coefficient matrix $\tilde{B}(L)$ is a nonlinear function of the contemporaneous parameter matrix B_0 and the structural parameter matrix $B(L)$. In contrast to the SVAR, the VAR residuals u_t are contemporaneously correlated, which impedes an unbiased economic interpretation. The VAR residuals are assumed to be linked to the SVAR shocks by the following:

$$u_t = {B_0}^{-1}\varepsilon_t \text{ , } E\,[u_t {u'}_\tau] = \Sigma_u = {B_0}^{-1}{B_0}^{-1\prime}. \quad \text{(A.6)}$$

Given the covariance matrix ε_t being equal to the identity matrix, it is necessary to impose n(n-1)/2 restrictions to estimate the structural form. The most general approach is to separate the residuals into orthogonal shocks by calculating a Cholesky decomposition of the covariance matrix Σ_u. The first variable in this system responds to its own exogenous shock, the second variable responds to its own plus the first's, and so on. The results, therefore, depend on the ordering of the variables. By Wold's theorem, being covariance-stationary, the coefficients of a VAR(p) can be written recursively as the coefficients of an infinite-order moving-average vector. Impulse Response Functions are then estimated iteratively by rewriting VAR(p) into its companion form, a VAR(1):

$$\widehat{IR}(0) = {B_0}^{-1} \quad \text{(A.7)}$$

$$\widehat{IR}(1) = \Phi^1 {B_0}^{-1}$$

$$\widehat{IR}(2) = \Phi^2 {B_0}^{-1}$$

$$\vdots$$

Where the matrix contains the coefficients of the VAR (1).

The method of Local Projections, as proposed in Jordà (2005), presents as an alternative approach to estimate impulse response functions. The first step consists of OLS regressions for each forecast horizon:

$$y_{t+h} = \alpha^h + B_1^h y_{t-1} + \cdots + B_p^h y_{t-p} + u_{t+h}^h,\ h = 0,1, \ldots, H\text{-}1 \quad \text{(A.8)}$$

Where α^h is a vector of constants, and B_i^h are parameter matrices for lag p and forecast horizon h. The vector elements u_{t+h}^h are autocorrelated and/or heteroscedastic disturbances. The collection of all regressions of Equation (A.1) are called Local Projections (LP). The slope matrix B_1^h can be interpreted as the response to a reduced form shock in t. Structural impulse responses are then estimated by the following:

$$\widehat{IR}(t, h, d_i) = \hat{B}_1^h d_i, \quad \text{(A.9)}$$

Where $d_i = {B_0}^{-1}$. As in the SVAR approach, the shock matrix d_i must be identified from a linear VAR. The LP approach thus does not overcome the problem of

identification. Given the serial correlation of u_{t+h}^{h} Jordà (2005) proposes to estimate robust standard errors using the approach by Newey and West (1987).

This method can also be easily extended to cases in which exogenous shocks are identified outside an auto regressive system. Once an exogenous shock is identified, impulse responses can be directly estimated using OLS regressions:

$$y_{t+h} = \alpha^{h} + \beta_h shock_t + \Phi x_t + u_{t+h}^{h},\ h = 0,1, \dots, H\text{-}1 \qquad \text{(A.10)}$$

where α^{h} denotes the regression constant, x_t is a vector of control variables and $shock_t$ is the identified shock variable. The coefficient β_h corresponds to the response of y at time $t + h$ to the shock variable at time t. The impulse responses are the sequence of all estimated β_h . As above robust standard errors can be estimated using the approach by Newey and West (1987).

This method is also easily applied to panel data, which is the case for this study. Estimating impulse responses for data frames as such goes as follows:

$$y_{i,t+h} = \alpha^{i,h} + \beta_h shock_{i,t} + \gamma_h x_{i,t} + \varepsilon_{i,t+h},\ h = 0,1, \dots, H\text{-}1 \qquad \text{(A.11)}$$

where $\alpha^{i,h}$ denotes cross-sectional fixed effects, $x_{i,t}$ is a vector of control variables, and $shock_{i,t}$ denotes the identified shock variable. As it is often used for panel data cumulative impulse response functions are estimated using the difference between lagged $y_{i,t}$ and each forecast horizon as the endogenous variable, Equation (A.11) is then rewritten as:

$$y_{i,t+h} - y_{i,t-1} = \alpha^{i,h} + \beta_h shock_{i,t} + \gamma_h x_{i,t} + \varepsilon_{i,t+h} \qquad \text{(A.12)}$$

B- Dataset

Table B1: List of countries from the dataset

List of countries in the dataset			
Argentina	Georgia	Mexico	Slovak Republic
Armenia	Guatemala	Moldova	Slovenia
Brazil	India	Paraguay	South Africa
Bulgaria	Indonesia	Philippines	Sri Lanka
Colombia	South Korea	Poland	Thailand
Croatia	Kyrgyz Republic	Romania	Ukraine
Czech Republic	Lithuania	Russia	Uruguay
Estonia	Malasya	Saudi Arabia	

Source: By the author

Table C.1: Local Projection coefficients for Liberal Democracy index shock on FDI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
LibDem	**6.588,5**	**10.682,2**	**14.325,4**	**16.171,6**	**19.802,3**	**29.924,5**	**39.891,1**	**28.228,8**	15.492,3	11.601,3
	(3.232,3)	(5.074,1)	(5.824,5)	(4.313,3)	(4.380,7)	(8.702,2)	(11.463,9)	(15.731,7)	(14.070,2)	(11.238,1)
RIR	-50,8	-11,3	-4,8	33,1	103,3	120,8	231,0	253,4	170,7	102,5
	(47,2)	(49,3)	(50,2)	(61,7)	(82,9)	(98,1)	(168,0)	(206,7)	(133,6)	(102,4)
GDPg	**297,3**	**369,0**	**528,9**	**583,3**	**662,0**	**919,7**	**876,1**	**507,9**	**447,6**	**495,0**
	(126,6)	(117,7)	(90,3)	(119,2)	(171,0)	(154,4)	(140,0)	(121,2)	(105,0)	(81,8)
GDPgW	**743,3**	**1.353,0**	1.046,5	**1.514,3**	1.096,4	765,5	**1.138,6**	1.173,1	872,3	-91,9
	(220,2)	(495,7)	(690,9)	(548,9)	(833,3)	(546,6)	(580,1)	(983,4)	(922,7)	(432,3)
Debt	27,8	22,0	**67,0**	**118,5**	**169,5**	**250,6**	**283,2**	**272,5**	**267,2**	**306,7**
	(21,5)	(28,0)	(39,9)	(39,5)	(33,8)	(27,6)	(33,1)	(49,8)	(27,6)	(42,2)
RIRUs	**325,0**	**519,1**	270,0	346,7	899,9	**1.403,0**	**1.880,0**	**1.512,6**	372,3	243,8
	(175,0)	(305,1)	(464,1)	(621,3)	(707,2)	(443,7)	(518,5)	(823,0)	(1.001,0)	(988,6)
VIX	50,5	22,3	110,5	**229,7**	181,2	205,6	143,5	-11,5	-64,8	-225,8
	(50,1)	(100,0)	(113,6)	(73,6)	(111,5)	(125,2)	(141,6)	(219,2)	(261,0)	(144,7)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.2: Local Projection coefficients for Liberal Democracy index shock on PCI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
LibDem	8.720,7	4.824,2	7.522,0	8.847,8	**21.874,5**	**34.242,4**	**43.251,9**	**40.247,8**	**34.522,5**	23.641,5
	(5.371,2)	(7.706,4)	(9.752,6)	(11.393,0)	(13.205,7)	(11.825,8)	(11.116,2)	(19.842,3)	(12.710,1)	(21.486,8)
RIR	46,5	-47,5	37,6	224,2	258,7	292,3	**403,4**	**361,7**	**253,1**	**270,9**
	(70,2)	(86,1)	(90,7)	(167,1)	(181,1)	(182,1)	(229,9)	(154,6)	(86,0)	(132,0)
GDPg	**167,0**	**241,1**	6,0	-143,1	**-200,6**	123,9	-109,8	-82,9	132,4	84,3
	(62,1)	(123,3)	(89,0)	(144,0)	(121,1)	(249,4)	(154,8)	(141,7)	(242,5)	(151,9)
GDPgW	-1.094,2	**-2.689,5**	-297,8	-913,0	-1.294,0	-1.581,0	253,7	54,3	**-4.353,0**	**-3.395,6**
	(936,9)	(1.439,7)	(860,6)	(1.748,3)	(1.185,7)	(2.020,8)	(2.028,9)	(2.041,1)	(1.366,9)	(947,4)
Debt	-56,4	-46,3	-44,0	-42,7	-45,0	-17,9	-37,0	-14,5	45,4	28,1
	(53,1)	(35,4)	(35,1)	(33,8)	(36,3)	(31,4)	(36,7)	(45,3)	(27,8)	(27,5)
RIRUs	801,1	168,6	777,9	**2.437,8**	**3.572,4**	**3.487,5**	**3.121,5**	1.781,1	1.358,9	609,4
	(512,2)	(919,2)	(879,1)	(1.211,4)	(1.053,1)	(892,7)	(1.131,9)	(1.483,5)	(1.562,4)	(1.649,6)
VIX	-268,0	108,3	**368,9**	140,1	62,7	-99,6	-75,3	-209,7	**-827,6**	**-652,9**
	(231,6)	(190,7)	(130,0)	(193,6)	(187,6)	(281,4)	(262,5)	(458,5)	(338,3)	(182,2)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.3: Local Projection coefficients for Horizontal Accountability shock on FDI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
HorAcc	1.381,6	2.000,2	**3.717,5**	**4.772,8**	**6.756,8**	**9.677,2**	**13.810,8**	**14.272,1**	**13.296,3**	**14.249,5**
	(994,9)	(1.220,1)	(1.502,6)	(1.677,4)	(1.971,9)	(2.910,4)	(3.612,3)	(5.654,9)	(3.528,7)	(4.320,1)
RIR	-53,2	-16,5	-10,8	26,1	95,4	106,3	204,7	231,7	161,5	97,2
	(47,2)	(47,8)	(48,4)	(62,3)	(84,9)	(99,5)	(174,8)	(211,1)	(130,0)	(96,8)
GDPg	**294,4**	**366,0**	**528,8**	**584,0**	**663,5**	**917,7**	**862,1**	**513,1**	**491,7**	**549,3**
	(128,7)	(115,5)	(85,4)	(114,0)	(164,6)	(156,9)	(127,0)	(104,2)	(114,3)	(95,5)
GDPgW	**755,1**	**1.356,1**	1.033,5	**1.496,5**	1.081,1	760,6	**1.139,0**	1.171,8	778,9	-243,3
	(213,4)	(498,2)	(693,8)	(554,7)	(850,5)	(574,8)	(633,7)	(1.055,1)	(967,1)	(417,1)
Debt	28,1	21,8	**69,6**	**124,6**	**181,1**	**269,3**	**317,6**	**318,4**	**312,9**	**353,0**
	(21,1)	(28,2)	(38,7)	(36,2)	(32,5)	(29,5)	(41,7)	(59,3)	(22,0)	(40,6)
RIRUs	**321,8**	**510,4**	283,8	374,9	955,9	**1.481,8**	**2.015,7**	**1.728,4**	589,1	452,9
	(176,1)	(307,6)	(459,8)	(613,1)	(688,3)	(430,6)	(521,6)	(835,2)	(986,0)	(994,7)
VIX	50,3	21,6	106,2	**223,9**	176,3	202,0	137,8	-10,0	-76,9	**-251,4**
	(49,0)	(101,5)	(115,5)	(73,5)	(112,8)	(127,5)	(143,7)	(225,6)	(265,4)	(144,2)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.4: Local Projection coefficients for Horizontal Accountability shock on PCI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
HorAcc	**1.741,3**	-78,4	-843,3	-976,4	1.447,1	3.460,4	**5.510,7**	4.194,5	4.396,1	2.668,8
	(839,0)	(1.145,0)	(1.956,3)	(2.334,7)	(2.610,1)	(2.602,3)	(2.393,3)	(3.708,3)	(3.058,7)	(3.411,2)
RIR	43,2	-51,2	30,6	215,7	243,9	269,5	370,1	**326,6**	**218,9**	**247,1**
	(69,6)	(85,0)	(88,7)	(164,6)	(178,2)	(179,5)	(224,4)	(144,9)	(85,6)	(124,5)
GDPg	**162,6**	**235,0**	-9,9	-157,4	**-220,0**	101,6	-142,1	-128,6	86,6	54,6
	(62,9)	(122,9)	(90,7)	(143,9)	(115,3)	(241,2)	(154,5)	(142,3)	(250,2)	(162,2)
GDPgW	-1.078,1	**-2.683,1**	-273,9	-894,7	-1.286,4	-1.577,0	263,5	69,2	**-4.342,2**	**-3.370,4**
	(946,3)	(1.437,6)	(852,7)	(1.736,8)	(1.163,9)	(1.993,0)	(2.018,7)	(2.021,5)	(1.376,3)	(961,6)
Debt	-56,2	-49,1	-51,6	-52,8	-55,8	-29,0	-42,6	-19,3	48,0	30,4
	(54,2)	(34,2)	(35,1)	(37,0)	(41,2)	(40,1)	(48,9)	(47,4)	(30,8)	(28,4)
RIRUs	795,6	150,0	732,2	**2.381,8**	**3.508,7**	**3.411,6**	**3.054,1**	1.691,1	1.298,5	578,9
	(506,1)	(903,9)	(850,3)	(1.184,1)	(1.015,1)	(865,0)	(1.117,6)	(1.442,8)	(1.513,6)	(1.611,8)
VIX	-268,0	108,9	**371,8**	142,6	59,3	-105,0	-81,7	-219,7	**-838,6**	**-654,4**
	(232,7)	(191,1)	(128,9)	(195,7)	(188,3)	(281,7)	(263,1)	(456,6)	(336,4)	(181,6)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.5: Local Projection coefficients for Clientelism shock on FDI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
Client	**-8.427,8**	**-12.478,0**	**-22.714,3**	**-27.261,8**	**-31.001,5**	**-25.974,1**	**-25.118,5**	**-19.294,3**	-12.009,4	7.808,3
	(3.247,4)	(5.583,4)	(8.080,5)	(7.799,9)	(6.329,8)	(6.659,8)	(8.979,7)	(9.064,7)	(8.310,5)	(14.236,1)
RIR	-42,8	0,0	18,8	61,2	130,9	131,2	222,6	244,9	165,4	83,5
	(47,0)	(48,3)	(52,8)	(69,6)	(93,7)	(109,1)	(180,2)	(215,6)	(132,4)	(98,1)
GDPg	**298,0**	**369,5**	**543,0**	**606,0**	**695,0**	**940,6**	**871,3**	**492,0**	**439,8**	**460,9**
	(126,2)	(116,5)	(90,8)	(139,8)	(201,3)	(180,3)	(154,4)	(112,4)	(95,3)	(71,3)
GDPgW	**807,3**	**1.441,5**	**1.150,0**	**1.619,4**	1.179,9	815,7	**1.189,1**	1.199,6	892,4	-63,3
	(222,6)	(501,4)	(675,3)	(540,4)	(815,6)	(504,8)	(575,8)	(973,7)	(913,1)	(423,8)
Debt	22,5	13,6	55,4	**105,4**	**155,3**	**232,1**	**263,1**	**264,9**	**265,8**	**299,9**
	(19,9)	(25,9)	(36,5)	(36,8)	(32,6)	(29,4)	(40,7)	(49,3)	(29,2)	(44,2)
RIRUs	**286,9**	458,1	205,0	271,7	807,0	**1.267,5**	**1.705,8**	**1.370,4**	296,0	212,0
	(172,5)	(293,6)	(434,8)	(614,7)	(700,8)	(417,1)	(500,4)	(765,9)	(935,7)	(951,1)
VIX	66,8	46,0	144,6	**267,3**	**215,4**	**228,2**	160,6	-7,4	-60,4	-228,8
	(51,0)	(104,2)	(113,2)	(76,7)	(121,4)	(127,0)	(151,8)	(220,6)	(254,6)	(138,9)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.6: Local Projection coefficients for Clientelism shock on PCI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
Client	-1.052,9	-7.704,8	**-21.887,5**	-20.788,7	-22.488,8	-19.520,1	-15.911,6	-17.605,8	16.724,8	13.057,8
	(6.708,6)	(5.422,3)	(8.417,9)	(14.202,3)	(16.501,1)	(19.890,2)	(17.635,7)	(18.879,7)	(22.074,3)	(22.727,6)
RIR	41,6	-39,2	65,3	248,5	273,2	291,3	383,0	**340,9**	**200,9**	**234,7**
	(62,3)	(85,7)	(96,5)	(174,4)	(186,9)	(196,7)	(234,9)	(151,7)	(99,6)	(134,3)
GDPg	**153,3**	**243,6**	28,9	-121,8	-185,1	128,8	-130,4	-118,8	27,9	19,3
	(58,2)	(121,6)	(96,4)	(169,5)	(138,4)	(239,0)	(155,2)	(137,6)	(233,0)	(167,7)
GDPgW	-1.064,4	**-2.637,0**	-210,2	-837,1	-1.228,8	-1.540,4	292,0	85,4	**-4.301,4**	**-3.337,2**
	(974,3)	(1.455,7)	(854,0)	(1.749,2)	(1.169,1)	(1.987,9)	(1.991,1)	(2.000,6)	(1.355,8)	(940,1)
Debt	-60,8	-50,6	-51,1	-50,1	-61,0	-40,7	-62,5	-29,8	23,6	15,4
	(51,9)	(35,4)	(36,9)	(37,6)	(43,5)	(38,6)	(42,0)	(46,0)	(31,5)	(31,4)
RIRUs	769,1	137,4	740,1	**2.395,1**	**3.472,8**	**3.333,7**	**2.931,2**	1.581,7	1.213,0	542,5
	(503,9)	(898,2)	(863,9)	(1.180,3)	(999,8)	(859,0)	(1.104,4)	(1.374,4)	(1.485,8)	(1.574,1)
VIX	-264,4	122,8	**400,6**	168,4	86,5	-84,7	-67,2	-210,7	**-847,0**	**-657,1**
	(240,8)	(195,7)	(127,5)	(207,6)	(201,7)	(294,5)	(274,8)	(460,7)	(334,3)	(176,9)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.7: Local Projection coefficients for Free and Fair elections shock on FDI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
FreeFair	**4.531,2**	**6.415,3**	**10.210,9**	**11.175,8**	**16.259,8**	**23.321,6**	**23.324,6**	14.125,6	8.262,9	5.011,5
	(2.162,7)	(3.688,6)	(5.017,0)	(4.811,1)	(5.497,7)	(7.852,3)	(11.953,8)	(9.559,4)	(6.650,9)	(4.063,8)
RIR	-50,1	-11,6	-4,7	31,4	104,0	121,5	224,0	244,3	165,8	97,5
	(47,5)	(50,0)	(51,3)	(62,9)	(84,4)	(101,5)	(170,7)	(208,2)	(133,0)	(99,7)
GDPg	**281,5**	**345,3**	**498,8**	**553,5**	**627,6**	**871,9**	**821,7**	**462,9**	**422,1**	**476,1**
	(127,8)	(111,9)	(83,4)	(119,1)	(169,9)	(159,3)	(136,0)	(104,9)	(96,3)	(79,3)
GDPgW	**791,1**	**1.425,9**	1.136,0	**1.599,4**	1.194,2	886,6	**1.251,7**	1.238,7	903,7	-65,3
	(212,9)	(520,0)	(714,7)	(578,2)	(866,1)	(594,9)	(601,0)	(993,3)	(935,4)	(422,9)
Debt	21,7	12,8	54,3	**103,8**	**150,4**	**219,8**	**244,4**	**247,8**	**253,7**	**298,0**
	(20,8)	(27,0)	(37,6)	(37,4)	(30,1)	(27,4)	(40,3)	(52,2)	(33,5)	(47,5)
RIRUs	**324,4**	512,4	279,5	354,1	923,3	**1.427,0**	**1.856,8**	**1.471,8**	349,3	225,4
	(173,4)	(316,7)	(479,0)	(634,0)	(718,5)	(459,8)	(534,7)	(803,7)	(975,9)	(962,3)
VIX	56,9	31,7	121,7	**240,1**	190,1	213,8	148,0	-13,9	-68,0	-226,7
	(50,0)	(100,9)	(114,6)	(78,4)	(117,5)	(132,8)	(151,4)	(222,5)	(258,9)	(145,2)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.8: Local Projection coefficients for Free and Fair elections shock on PCI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
FreeFair	1.145,2	3.604,6	**9.084,4**	5.342,7	**11.659,2**	10.611,1	**18.498,2**	15.426,8	**17.077,6**	**15.565,2**
	(4.603,4)	(3.912,6)	(4.304,5)	(4.904,5)	(6.265,7)	(7.849,3)	(7.834,9)	(10.574,2)	(6.585,2)	(8.107,3)
RIR	41,5	-46,7	41,8	222,5	253,5	277,2	**388,1**	**343,3**	**240,3**	**268,6**
	(67,7)	(86,2)	(91,1)	(167,3)	(182,1)	(183,1)	(227,1)	(151,8)	(90,1)	(131,6)
GDPg	**150,7**	**229,2**	-13,0	-158,7	**-233,9**	83,2	-164,3	-146,0	74,6	48,5
	(66,2)	(123,2)	(92,8)	(152,5)	(129,0)	(250,1)	(155,8)	(149,6)	(252,9)	(178,2)
GDPgW	-1.062,6	**-2.650,0**	-228,3	-871,0	-1.219,1	-1.520,8	347,5	130,4	**-4.284,6**	**-3.343,8**
	(962,4)	(1.455,7)	(881,0)	(1.754,4)	(1.201,7)	(2.023,5)	(2.033,1)	(2.047,7)	(1.366,6)	(916,3)
Debt	-61,3	-50,9	-51,9	-50,5	-64,5	-47,5	**-76,0**	-46,9	16,4	5,0
	(51,7)	(33,9)	(34,5)	(35,2)	(39,9)	(38,1)	(43,7)	(50,3)	(32,1)	(30,1)
RIRUs	776,6	169,1	807,0	**2.436,7**	**3.556,3**	**3.407,2**	**3.051,5**	1.691,3	1.300,1	592,7
	(509,0)	(917,2)	(877,3)	(1.198,2)	(1.051,7)	(865,1)	(1.130,5)	(1.450,2)	(1.532,7)	(1.610,4)
VIX	-265,0	113,4	**377,9**	145,2	68,1	-99,5	-73,5	-215,4	**-835,0**	**-657,5**
	(236,1)	(193,4)	(131,4)	(195,0)	(190,6)	(284,7)	(267,0)	(459,3)	(338,4)	(178,9)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.9: Local Projection coefficients for Female Participation in Politics shock on FDI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
GenPp	**9.815,3**	**7.874,8**	5.816,3	6.708,2	4.929,9	4.495,8	9.175,9	9.350,1	5.302,5	2.410,2
	(3.257,6)	(4.245,7)	(4.662,7)	(6.844,1)	(5.728,1)	(7.666,3)	(6.636,7)	(6.631,2)	(7.983,8)	(7.400,1)
RIR	-36,0	-3,5	-5,0	31,2	95,8	104,2	206,3	233,7	157,2	91,1
	(44,6)	(50,6)	(51,1)	(68,6)	(83,5)	(96,7)	(166,7)	(206,0)	(124,3)	(94,7)
GDPg	**301,0**	**364,9**	**516,5**	**574,5**	**649,2**	**900,8**	**849,8**	**477,7**	**424,9**	**477,6**
	(125,7)	(117,3)	(84,2)	(111,9)	(165,8)	(157,4)	(148,4)	(113,7)	(102,1)	(81,1)
GDPgW	**891,7**	**1.469,5**	1.128,7	**1.589,8**	1.139,7	790,9	**1.176,1**	1.195,0	884,9	-74,5
	(211,9)	(527,0)	(712,2)	(563,2)	(827,8)	(526,3)	(564,6)	(984,6)	(938,4)	(414,2)
Debt	33,0	23,4	63,9	**115,3**	**161,8**	**235,6**	**273,0**	**276,8**	**272,7**	**308,8**
	(22,0)	(29,7)	(40,5)	(39,2)	(31,0)	(29,1)	(48,5)	(57,3)	(42,0)	(60,1)
RIRUs	**387,6**	**550,2**	278,6	357,0	871,8	**1.324,4**	**1.814,8**	**1.483,7**	357,2	224,4
	(156,3)	(316,9)	(479,1)	(670,8)	(722,4)	(430,3)	(548,2)	(850,8)	(943,3)	(954,1)
VIX	**80,9**	46,8	126,8	**245,5**	186,4	205,1	142,6	-20,2	-71,4	-227,5
	(48,5)	(102,9)	(120,5)	(87,8)	(113,8)	(126,4)	(150,5)	(220,1)	(260,1)	(139,5)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.10: Local Projection coefficients for Female Participation in Politics shock on PCI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
GenPp	-9.006,3	**-14.090,6**	-6.531,6	-4.228,6	-8.619,8	-9.377,3	**-18.298,9**	-12.329,1	**-23.625,5**	**-21.438,6**
	(7.406,1)	(7.067,5)	(4.636,2)	(9.321,3)	(9.055,5)	(10.870,6)	(8.838,9)	(10.827,7)	(13.778,3)	(12.834,4)
RIR	22,0	-79,3	19,4	209,8	229,8	254,5	350,0	**318,1**	**203,3**	**236,6**
	(66,6)	(87,7)	(88,9)	(164,2)	(172,4)	(169,3)	(214,3)	(139,4)	(87,3)	(127,8)
GDPg	**137,8**	**219,8**	-15,1	-159,7	**-241,3**	74,9	-177,4	-157,6	20,5	3,2
	(68,6)	(129,8)	(86,5)	(143,0)	(114,4)	(237,6)	(156,8)	(145,9)	(262,1)	(185,5)
GDPgW	-1.189,6	**-2.868,3**	-344,1	-937,6	-1.334,8	-1.610,2	222,5	62,4	**-4.262,2**	**-3.234,0**
	(988,8)	(1.446,2)	(848,9)	(1.730,2)	(1.156,3)	(1.946,7)	(1.932,9)	(1.964,1)	(1.344,3)	(877,6)
Debt	-68,2	**-61,6**	**-55,9**	-54,5	**-74,0**	-59,4	**-103,2**	-64,4	-23,0	-28,9
	(53,4)	(30,2)	(33,4)	(39,0)	(44,3)	(48,4)	(48,6)	(57,1)	(38,8)	(39,8)
RIRUs	692,6	26,2	674,8	**2.352,6**	**3.378,9**	**3.224,0**	**2.705,4**	1.447,2	960,8	369,6
	(525,0)	(898,5)	(886,4)	(1.204,1)	(964,9)	(852,5)	(1.105,8)	(1.311,9)	(1.391,5)	(1.503,4)
VIX	-293,0	67,1	**354,9**	132,2	46,1	-115,2	-92,1	-223,5	**-822,5**	**-618,6**
	(240,7)	(197,9)	(136,4)	(191,7)	(177,6)	(275,6)	(248,2)	(445,6)	(330,3)	(172,8)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.11: Local Projection coefficients for Political Instability shock on FDI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
Inst	870,4	226,6	-1.872,0	-3.034,2	**-4.008,5**	-2.945,0	-3.869,6	**-10.184,8**	**-9.961,2**	-4.846,8
	(956,7)	(1.075,0)	(1.410,3)	(2.052,5)	(2.010,0)	(1.879,5)	(2.886,7)	(3.179,5)	(4.003,6)	(3.455,8)
RIR	-59,4	-6,5	12,6	56,6	139,0	149,6	250,7	286,8	173,4	68,1
	(54,3)	(51,3)	(56,2)	(74,1)	(100,6)	(119,0)	(201,8)	(236,5)	(155,0)	(117,3)
GDPg	**308,5**	**386,2**	**564,9**	**629,3**	**721,2**	**994,8**	**857,0**	**381,1**	**408,4**	**478,7**
	(137,8)	(122,4)	(96,6)	(145,6)	(215,0)	(191,2)	(174,9)	(115,8)	(92,3)	(108,1)
GDPgW	**790,4**	**1.320,8**	823,8	**1.347,8**	885,1	491,6	**1.251,0**	**1.612,5**	907,7	143,5
	(228,1)	(488,5)	(546,5)	(439,1)	(619,7)	(340,7)	(553,9)	(902,1)	(802,8)	(367,2)
Debt	38,8	16,4	42,7	**83,4**	**135,2**	**226,7**	**214,4**	**149,4**	**237,5**	**301,1**
	(31,8)	(34,4)	(50,8)	(42,3)	(24,9)	(40,5)	(78,7)	(56,2)	(60,5)	(70,7)
RIRUs	300,5	525,0	401,3	268,1	841,2	**1.434,4**	**1.395,7**	621,1	261,7	-115,0
	(204,0)	(364,9)	(502,7)	(751,7)	(755,3)	(446,7)	(552,2)	(625,4)	(910,9)	(987,8)
VIX	62,0	26,7	99,5	**208,1**	158,3	**188,5**	128,2	-27,2	-48,8	**-205,1**
	(62,2)	(107,8)	(120,1)	(78,7)	(105,7)	(109,7)	(144,5)	(200,8)	(234,7)	(123,3)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.12: Local Projection coefficients for Political Instability shock on PCI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
Inst	-971,2	-2.229,8	-2.595,8	-3.016,7	-783,7	2.677,3	-540,6	1.695,5	3.148,0	**3.747,5**
	(1.636,4)	(1.808,5)	(1.837,6)	(2.206,6)	(1.816,5)	(2.901,7)	(3.072,5)	(3.365,4)	(4.533,8)	(1.955,3)
RIR	68,5	1,7	80,8	308,0	324,5	323,3	**424,3**	**392,6**	**259,7**	**266,9**
	(82,0)	(89,5)	(92,5)	**(181,7)**	(203,3)	(211,5)	(246,7)	(175,2)	(96,5)	(142,2)
GDPg	**146,7**	**257,9**	10,6	-103,5	-185,8	96,8	-207,0	-71,8	92,3	73,4
	(70,1)	(141,4)	(92,5)	(164,0)	(139,3)	(294,9)	(175,6)	(149,0)	(272,8)	(140,3)
GDPgW	-1.168,7	**-3.009,8**	-499,7	-1.335,4	**-1.800,2**	-1.878,1	591,2	-720,5	**-4.234,4**	**-2.973,5**
	(1.027,3)	(1.307,6)	(821,3)	(1.617,7)	(760,4)	(1.970,7)	(2.309,7)	(1.739,0)	(1.421,1)	(635,0)
Debt	-92,1	-88,4	**-82,9**	**-79,2**	-61,1	-23,0	**-124,5**	-9,8	45,2	3,1
	(71,2)	(53,8)	(48,2)	(23,5)	(44,1)	(52,7)	(28,2)	(46,9)	(45,4)	(40,4)
RIRUs	772,2	558,5	928,4	**2.949,1**	**4.395,9**	**4.061,5**	**2.536,2**	**2.902,6**	1.149,0	-403,8
	(553,9)	(926,8)	(1.095,6)	(1.218,7)	(917,3)	(1.013,6)	(1.387,1)	(1.333,9)	(1.732,6)	(1.607,0)
VIX	-285,9	98,3	**348,8**	125,9	68,3	-93,4	-83,1	-221,6	**-836,4**	**-691,4**
	(253,5)	(218,0)	(142,4)	(213,5)	(175,9)	(277,5)	(268,4)	(446,0)	(330,2)	(155,8)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.13: Local Projection coefficients for Rule of Law shock on FDI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
RoL	**12.518,6**	**17.068,3**	**17.328,0**	**16.235,7**	**18.645,5**	**33.580,0**	**67.103,8**	58.044,1	13.579,7	17.639,2
	(7.051,4)	(9.273,4)	(8.302,5)	(6.551,0)	(5.999,0)	(11.402,2)	(17.159,6)	(41.102,3)	(27.417,9)	(25.381,9)
RIR	-55,3	-17,7	-14,7	21,5	89,9	101,7	221,3	262,9	163,7	103,5
	(46,2)	(47,5)	(47,0)	(59,7)	(81,1)	(92,8)	(162,8)	(215,0)	(132,7)	(107,0)
GDPg	**298,7**	**367,0**	**516,8**	**567,6**	**642,0**	**891,4**	**874,4**	**558,4**	**441,3**	**509,8**
	(121,9)	(114,8)	(87,9)	(115,1)	(161,7)	(142,8)	(119,0)	(159,5)	(116,9)	(95,6)
GDPgW	**714,3**	**1.338,4**	1.051,1	**1.518,2**	1.097,8	753,2	**1.068,2**	1.091,9	860,5	-133,8
	(228,8)	(505,4)	(703,9)	(561,6)	(846,1)	(569,5)	(623,6)	(990,5)	(907,3)	(493,4)
Debt	29,9	23,7	**65,5**	**114,6**	**163,6**	**242,9**	**275,9**	**262,8**	**261,3**	**302,3**
	(21,4)	(26,5)	(39,1)	(39,1)	(32,8)	(27,7)	(31,2)	(44,7)	(29,9)	(43,8)
RIRUs	**340,3**	**532,4**	264,8	330,0	873,8	**1.378,2**	**1.899,5**	**1.563,1**	341,1	233,0
	(175,3)	(294,2)	(463,0)	(624,2)	(706,5)	(447,2)	(527,0)	(887,1)	(1.001,4)	(992,3)
VIX	49,7	22,3	112,5	**230,4**	179,7	200,8	134,6	-9,2	-68,1	-230,7
	(49,6)	(98,8)	(112,5)	(75,0)	(113,8)	(127,9)	(138,7)	(229,0)	(259,3)	(145,6)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.

Table C.14: Local Projection coefficients for Rule of Law shock on PCI net inflow.

Variables	Forecast Horizon									
	t + 1	t + 2	t + 3	t + 4	t + 5	t + 6	t + 7	t + 8	t + 9	t + 10
RoL	2.645,1	-784,4	-8.590,0	-10.467,7	-3.199,3	8.650,1	**28.239,9**	16.328,0	33.133,1	27.280,9
	(8.316,6)	(9.593,6)	(11.684,5)	(11.497,4)	(15.738,4)	(17.745,4)	(16.638,3)	(24.603,6)	(27.665,8)	(34.917,9)
RIR	40,1	-51,1	31,2	215,9	242,2	267,5	**377,2**	**335,3**	**239,6**	**266,5**
	(70,4)	(84,9)	(89,5)	(165,3)	(177,3)	(176,4)	(219,5)	(147,4)	(82,1)	(132,6)
GDPg	**154,5**	**234,9**	-9,7	-155,4	**-225,5**	92,3	-136,4	-116,5	123,8	96,6
	(66,5)	(124,9)	(85,3)	(141,4)	(114,2)	(244,6)	(148,4)	(137,1)	(248,9)	(133,5)
GDPgW	-1.080,1	**-2.682,2**	-271,6	-892,2	-1.278,6	-1.577,6	233,4	46,9	**-4.386,4**	**-3.446,2**
	(946,4)	(1.440,2)	(839,6)	(1.721,2)	(1.149,5)	(1.987,1)	(2.028,3)	(2.003,3)	(1.397,9)	(961,4)
Debt	-59,4	-49,3	-52,8	-54,2	-63,0	-39,9	-58,8	-35,7	32,4	19,6
	(52,0)	(34,6)	(34,6)	(37,3)	(42,2)	(40,3)	(41,6)	(46,2)	(30,3)	(30,1)
RIRUs	779,0	148,8	722,7	**2.368,9**	**3.468,4**	**3.363,8**	**3.012,1**	1.640,1	1.297,5	574,3
	(505,5)	(898,3)	(846,6)	(1.166,0)	(1.000,2)	(861,7)	(1.146,2)	(1.457,2)	(1.591,1)	(1.648,2)
VIX	-266,7	108,9	**370,5**	141,7	59,6	-105,4	-83,1	-219,6	**-834,9**	**-659,5**
	(232,1)	(191,2)	(128,4)	(194,6)	(186,7)	(281,0)	(262,8)	(456,3)	(338,7)	(182,8)

Source: By the author. In bold are the coefficients with p-value equal to or less than 0.1.