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ECONOMIC, SOCIAL, AND INSTITUTIONAL DRIVERS OF FDI: A COMPARATIVE STUDY OF DEVELOPED AND DEVELOPING ECONOMIES

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Abstract
This study examines the determinants of foreign direct investment inflows by categorising them into three overarching dimensions, which are economic, social, and institutional. Recognising the heterogeneity of global economies, the analysis differentiates between developed and developing countries according to income classifications. Based on panel data for 178 countries covering the period from 1996 to 2019. The empirical results reveal notable differences in the drivers of foreign direct investment across income groups. In developing countries, economic factors such as market size, trade openness, and macroeconomic stability emerge as the most influential determinants. This explains that investors in less mature markets place the greatest importance on strong economic fundamentals. In contrast, in developed economies, social factors, including infrastructure quality, education levels, and human capital development, play a more prominent role in attracting foreign direct investment. This reflects investors' greater responsiveness to social infrastructure and workforce capabilities in advanced markets. Institutional factors such as governance quality, regulatory frameworks, and political stability show a weak and statistically insignificant relationship with foreign direct investment inflows in both developed and developing countries. This finding challenges the prevailing view that strong institutions are a prerequisite for attracting foreign investment and indicates that their influence may be context-dependent or overshadowed by more immediate economic and social considerations. Overall, the study provides a nuanced understanding of the heterogeneous nature of foreign direct investment determinants and highlights the need for policy strategies that are tailored to the specific developmental stage and structural characteristics of each country. These insights can help policymakers align economic and social development priorities more effectively with the objective of enhancing foreign direct investment attractiveness.
Keywords: *Foreign Direct Investment, Economic Determinants, Social Infrastructure, Institutional Quality*

INTRODUCTION

Foreign direct investment (FDI) has emerged as a pivotal force in shaping the global economic landscape, particularly over the past two decades. It serves as a key channel for cross-border capital flows, technological advancement, managerial expertise, and integration into global value chains. According to Kang and Lee (2011), the surge in FDI within developing regions has been particularly pronounced, reflecting the strategic importance of foreign capital in fostering economic transformation and industrial upgrading. Data from the United Nations Conference on Trade and Development (UNCTAD) confirm this trend, with global inflows increasing from 204.8 billion United States dollars in 1990 to 1,539.9 billion United States dollars in 2019. Developing economies, in particular, experienced a dramatic rise in inflows during the same period—from 34.65 billion United States dollars to 684.7 billion United States dollars—underscoring their growing integration into the global investment landscape. The contributions of FDI to host economies are well documented in the literature. It facilitates capital accumulation, introduces advanced managerial practices, promotes international best practices in corporate governance, enables the transfer of modern technologies, and strengthens human capital development through skills training and knowledge diffusion. These combined effects contribute to job creation, productivity enhancement, and sustained economic growth, as noted by Ilhan (2007) and Kang and Lee (2011). Moreover, the spillover effects of FDI can extend beyond the directly receiving sectors, enhancing the competitiveness of domestic firms through demonstration effects, supplier linkages, and market access opportunities.

Recognizing these potential benefits, many developing nations have pursued liberalized investment policies aimed at attracting foreign capital, including reforms in regulatory frameworks, the establishment of investment promotion agencies, and the provision of fiscal incentives (Irfan & Ahmad, 2025; Khalid et al., 2025; Cizakca, 2024; Sadashiv, 2023; Nasir, 2022; Sheikh & Ahmad, 2020; Gherghina et al., 2019; Iamsiraroj, 2016; Mamingi & Martin, 2018). The emphasis on openness and policy reforms reflects the belief that FDI can act as a catalyst for structural transformation, industrial diversification, and integration into global production networks. Nonetheless, the literature also notes that the impact of FDI is not universally positive. Some scholars have identified potential adverse effects, such as the displacement of domestic investment, the crowding out of local firms, environmental degradation, and the widening of income inequality if benefits are not equitably distributed (Ali, 2015; Ali & Rehman, 2015; Arshad & Ali, 2016; Ali, 2018; Babu, 2019; Sabra, 2022; Ammar, 2025; Fateh & Poulin, 2025). In economies where institutional quality is weak, FDI may also lead to the concentration of market power in foreign-owned firms or exacerbate dependency on external capital flows. These potential risks underscore the importance of complementary policies—such as strengthening domestic institutions, fostering linkages between foreign and local firms, and ensuring environmental and social safeguards, to maximize the developmental benefits of FDI (Ali & Ahmad, 2016; Ali & Bibi, 2017; Ali & Audi, 2018; Roussel et al., 2021; Marc et al., 2021). Despite these concerns, the prevailing consensus in the empirical literature highlights the predominantly

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positive direct and indirect impacts of FDI, particularly in economies with limited domestic capital resources. Studies by Ang (2009), Begum et al. (2018), Hagan and Amoah (2019), Iram and Nishat (2009), and Jibir and Abdu (2017) consistently find that, under conducive policy and institutional conditions, FDI can be a critical driver of economic growth, competitiveness, and global economic integration.

The economic dimension encompasses indicators such as market size, trade openness, factor prices, and exchange rate stability. These aspects are critical in shaping investor perceptions of both profitability and risk. Larger markets provide greater revenue potential by offering access to a broad consumer base, which can support economies of scale and long-term business sustainability. Stable exchange rates limit currency risk and reduce uncertainty for international investors, thereby fostering an environment conducive to long-term planning and investment. Studies by Ahmad et al. (2016), Chen et al. (2006), and Lily et al. (2014) provide empirical evidence that economic stability, particularly in the form of consistent exchange rates and open trade policies, positively influences the flow of foreign capital. The social dimension includes factors such as infrastructure quality, human capital, innovation capacity, and global connectivity. These elements reflect the broader socio-economic environment and determine the ease with which business operations can be conducted. High-quality infrastructure facilitates the efficient movement of goods and services, while advanced telecommunications systems improve communication and coordination. Human capital, reflected in high levels of education and workforce skills, enhances labour productivity and fosters innovation (Audi et al., 2021; Audi et al., 2023; Bukhari et al., 2025). Technological readiness further enables firms to adopt advanced production processes and respond effectively to market changes. Such attributes make a country more attractive to foreign investors, as observed in the studies of Hintosova et al. (2018) and Asongu et al. (2018), who demonstrate the positive role of human capital and innovation in attracting international investment.

Institutional factors consist of governance quality, the strength of regulatory frameworks, and the degree of political stability. Strong institutions lower transaction costs by providing transparent rules, ensuring contract enforcement, and creating a predictable operating environment. This reduces the uncertainty associated with investment decisions and can improve investor confidence. However, the empirical evidence on the influence of institutional quality on foreign direct investment is not entirely consistent. Buchanan et al. (2012) and Dellis et al. (2017) report a strong positive link between institutional quality and investment inflows, indicating that better governance directly supports the attraction of foreign capital. In contrast, Asongu et al., (2018) and Peres et al., (2017) find weaker or insignificant effects in certain developing economies, explaining that while institutional quality may matter in theory, other factors such as market opportunities or natural resource availability can sometimes override governance concerns in influencing investment flows (Marc, 2011; Audi & Ali, 2023; Ali & Audi, 2023; Rafique et al., 2025; Umair et al., 2025).

This paper investigates the determinants of foreign direct investment inflows across 178 countries and differentiates between developed and developing economies. It applies fixed and random effects models to assess the relative importance of economic, social, and institutional factors. From a policy standpoint, the findings provide strategic guidance for improving foreign direct investment attractiveness. Developing countries are advised to focus on enhancing market size, trade integration, cost efficiency, and macroeconomic stability. In contrast, developed economies may gain more by prioritising investments in infrastructure, education, innovation, and cultural openness. These insights enable policymakers to align national development agendas with the specific needs and comparative strengths of their economies, thereby fostering sustainable growth through increased foreign investment.

LITERATURE REVIEW

Foreign direct investment has become a cornerstone of global economic integration, particularly in the contemporary era of globalization and liberalized trade policies. Its contributions to capital formation, technology transfer, managerial innovation, and employment creation are well documented in both theoretical and empirical literature (Ilhan, 2007; Kang and Lee, 2011; Marc & Al Masri, 2024; Aman et al., 2025). The marked increase in foreign direct investment inflows to developing countries over the past several decades highlights the necessity of understanding the diverse determinants that influence investment decisions across different national contexts. These determinants vary in importance depending on the stage of economic development, structural characteristics of the host economy, and the policy environment (Audi, 2024; Audi et al., 2024; Ditta et al., 2025).

Classical theories of foreign direct investment, developed by scholars such as Dunning (1958), Hymer (1960), and Vernon (1966), emphasize different underlying motives for cross-border investment. Stephen Hymer's work on market imperfections stresses that multinational enterprises invest abroad to exploit monopolistic advantages and overcome competitive constraints in their domestic markets. Raymond Vernon's product life cycle theory explains foreign investment as a response to the shifting comparative advantages of countries during different stages of a product's development, from innovation to standardization. In parallel, early location theories stressed the role of natural resource availability, labor costs, and proximity to markets as fundamental factors influencing investment decisions.

John Dunning's Eclectic Paradigm, introduced in 1980, synthesizes these perspectives into what is widely known as the Ownership, Location, and Internalization framework. This paradigm posits that a firm's decision to invest abroad depends on the interaction of three sets of advantages. Ownership advantages relate to proprietary assets such as technology, brand reputation, and managerial skills. Location advantages involve host-country characteristics such as market size, infrastructure quality, institutional stability, and natural resources. Internalization advantages refer to a firm's ability to retain control over its proprietary assets and coordinate activities efficiently within its organizational structure rather than relying on external contractual arrangements. This framework underscores the significance of institutional quality and strategic management in shaping foreign direct investment behavior.

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More recent theoretical advancements, including those derived from endogenous growth theory, expand on these foundations by highlighting the role of foreign direct investment in advancing technology, enhancing skills, and fostering labor training in host economies (Ilhan, 2007; Iqbal et al., 2025; Ali et al., 2025). This perspective views foreign investment not only as a source of capital inflows but also as a driver of long-term productivity growth through spillover effects, innovation diffusion, and human capital development. These theories collectively explain that economic factors such as market size and stability, social factors such as education and infrastructure, and institutional factors such as governance and regulatory frameworks all interact to influence the volume and quality of foreign direct investment inflows (Ali et al., 2025).

Empirical research on the determinants of foreign direct investment has examined a wide range of economic, political, and institutional variables. Ilhan (2007) identified market size, trade policy, the development of financial systems, infrastructure quality, the availability of human capital, and political stability as key factors influencing investment inflows. These determinants operate through different channels, shaping investor perceptions of profitability, stability, and long-term viability in the host country. Building on this approach, Saini and Singhania (2018) organized these determinants into three main categories: economic, political, and institutional. Their analysis found that trade openness consistently exerts a positive influence on foreign direct investment inflows in both developed and developing nations, reflecting the importance of integration into global markets and the removal of trade barriers. Walsh and Yu (2010) adopted a sector-specific perspective and examined the drivers of foreign direct investment in different industries. Their findings explain that while macroeconomic indicators such as gross domestic product growth, inflation rates, and exchange rate stability are important for attracting foreign direct investment in general, factors such as infrastructure development and judicial independence are particularly relevant for investment in the tertiary sector, including finance, insurance, and professional services. This highlights the need for nuanced policy strategies that target sector-specific investment requirements rather than adopting a one-size-fits-all approach. In their study of the BRICS and MINT countries, Asongu, Nnanna, and Acha-Anyi (2018) found that market size, trade openness, and infrastructure quality were the most significant determinants of foreign direct investment. By contrast, institutional quality and the availability of natural resources appeared to be less influential in these contexts, explaining that investors may prioritize market potential and operational capacity over governance standards or resource availability in certain emerging economies.

Research by Hintosova et al. (2018) on the Visegrad countries offers further insight into the role of social and economic factors. They identified market size, labour costs, education, trade openness, and innovation as major determinants of foreign direct investment inflows. Interestingly, their findings indicate that higher wages and a well-educated workforce can attract investment by signaling higher productivity and a more skilled labour base. Conversely, high corporate tax rates and elevated domestic research and development spending may deter investment if they are perceived as increasing operational costs without generating immediate returns for foreign investors. The literature also reveals a distinction in the patterns of foreign direct investment between developed and developing countries. Developed economies tend to attract horizontal foreign direct investment, which is aimed at market expansion and is often influenced by social factors such as infrastructure quality, innovation capacity, and consumer demand. Developing countries, in contrast, typically attract vertical foreign direct investment, which focuses on resource extraction, cost efficiency, and export-oriented production. This type of investment is more strongly driven by economic fundamentals such as factor costs, natural resource availability, and trade policy (Dellis et al., 2017; Saini and Singhania, 2018; Ali et al., 2025).

Although institutional factors are theoretically important in influencing foreign direct investment, empirical evidence often reveals weak or statistically insignificant relationships, particularly in the context of developing regions. This explains that, in certain environments, investors may prioritize immediate economic opportunities such as market size, cost advantages, and natural resource availability over institutional robustness. Such findings imply that the absence of strong institutions does not necessarily deter investment, especially when other profitability-enhancing factors are present. In some cases, multinational enterprises may even adapt their operations to less developed institutional frameworks if the potential returns outweigh the perceived governance risks. The methodological approaches employed in the empirical literature on foreign direct investment are diverse. Traditional analyses often rely on pooled ordinary least squares estimation, fixed effects models, and random effects models to identify determinants across countries and over time. These models are valuable for exploring relationships within panel datasets but may be limited by issues of omitted variable bias and endogeneity. To address these concerns, many studies incorporate additional statistical tools that enhance robustness and reliability. More advanced econometric techniques have also been adopted to address methodological challenges inherent in foreign direct investment research. For example, the three-stage least squares approach accounts for simultaneity in multi-equation systems, allowing researchers to capture the complex interdependence between foreign direct investment, trade, and economic growth. Similarly, the generalized method of moments is widely used to address endogeneity concerns, particularly when lagged dependent variables or potentially correlated explanatory variables are included in the model. Studies by Iamsiraroj (2016) and Mamingi and Martin (2018) exemplify the application of these advanced techniques, providing more reliable estimates by correcting for biases associated with conventional regression models.

Despite the breadth of the existing literature, several research gaps remain. Many empirical studies focus on specific regions or subsets of countries, which limits the generalizability of their findings. Furthermore, the majority of analyses rely heavily on macroeconomic indicators, often neglecting qualitative aspects such as institutional quality, governance practices, and the strength of social infrastructure (Ali et al., 2025). These qualitative factors, while more challenging to quantify, may hold substantial explanatory power in understanding why foreign direct investment flows vary so widely

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across countries with similar economic profiles. Addressing these gaps requires not only methodological sophistication but also the incorporation of richer, multidimensional datasets that capture the interplay between economic, social, and institutional determinants.

FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH

Over recent decades, foreign direct investment has emerged as a key driver of global economic integration, particularly in the context of globalization and trade liberalization. Its growth has exceeded that of global trade and gross domestic product, as demonstrated by Fung et al. (2016), Kang and Lee (2021a), and Magalhaes and Africano (2017). Figure 1 presents global foreign direct investment inflow trends from 1970 to 2019, classified by income-based groupings of developed and developing economies. Foreign direct investment inflows remained relatively low until the early 1990s, after which a marked acceleration occurred, especially in developed nations. While these countries have historically attracted the majority of foreign direct investment, developing economies have experienced rapid increases in their share. Between 1990 and 2019, inflows to developing countries rose from 34.65 billion United States dollars to 684.7 billion United States dollars, representing nearly a twentyfold increase. In comparison, developed economies peaked at 1,282 billion United States dollars in 2007, followed by a period of greater volatility. Notably, foreign direct investment inflows to developing countries have demonstrated more consistent and sustained growth over time.

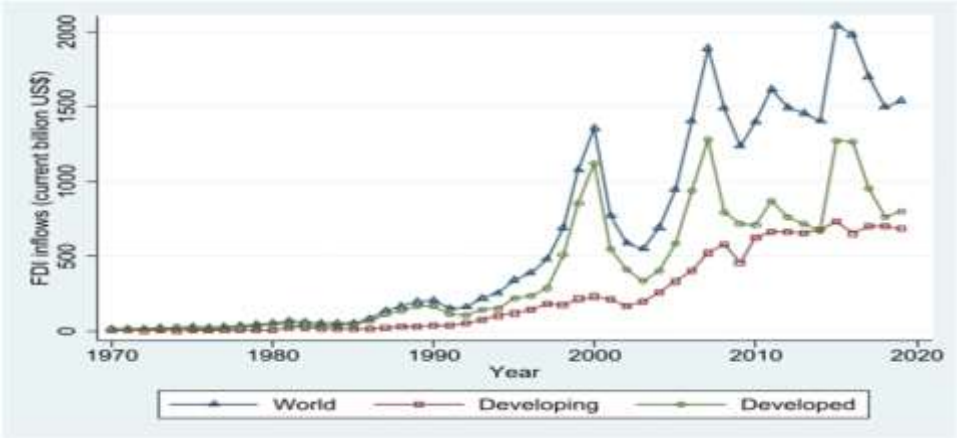

Fig 1: Trends of FDI inflows

Source: UNCTAD

Despite this expansion, the developmental impact of foreign direct investment remains debated. Neoclassical growth models explain that foreign direct investment enhances economic growth through capital accumulation and improvements in total factor productivity (Kang and Yoon, 2013; Ali et al., 2025). Endogenous growth theory builds on this perspective by emphasizing the role of foreign direct investment in technology transfer, skill enhancement, and labor training (Ilhan, 2007; Ali et al., 2025).

Empirical studies have tested these theoretical claims extensively. Iamsiraroj (2016), analyzing data from 124 countries between 1971 and 2010 using the three-stage least squares method, found a positive two-way relationship between foreign direct investment and economic growth. The study also highlighted trade openness, economic freedom, and labor force participation as factors that enhance growth. Similarly, Mamingi and Martin (2018), using data from 34 countries between 1988 and 2013 and applying the generalized method of moments, reported modest direct effects of foreign direct investment on growth but significant indirect benefits, particularly through infrastructure development.

Gherghina, Simionescu, and Hudea (2019) examined 11 Central and Eastern European countries from 2003 to 2016 using fixed and random effects models. Their study incorporated institutional quality, sustainable development goals, and control variables, including population, government spending, and trade. They found that the squared term of foreign direct investment had a positive and significant impact on economic growth, indicating the presence of nonlinear effects.

Conversely, some research has questioned the effectiveness of foreign direct investment. Babu (2019) argued that India's post-reform growth from 1990 to 2015 was driven more by domestic investment than by foreign direct investment. Mamingi and Martin (2018) also noted potential downsides, such as the crowding out of domestic investment. Nevertheless, the prevailing literature supports the view that foreign direct investment generally promotes growth, particularly in capital-scarce developing nations. Studies by Jibir and Abdu (2017), Hagan and Amoah (2019), Ang (2009), Begum, Sultana, and Hossain (2018), and Iram and Nishat (2009) affirm its positive role in enhancing economic performance in countries such as Nigeria, various African nations, Malaysia, Bangladesh, and Pakistan.

DETERMINANTS OF FOREIGN DIRECT INVESTMENT INFLOWS

To leverage the growth-enhancing potential of foreign direct investment, developing countries frequently liberalize their economies, reform regulatory frameworks, and implement policies designed to attract foreign capital (Korea Development Institute, 2017; Lee and Kang, 2023). Classical international business theories argue that foreign direct investment is primarily driven by economic and market-related factors such as monopolistic advantages, resource availability, and market inefficiencies (Dunning, 1958; Hymer, 1960; Kindleberger, 1969; Vernon, 1966). These theories explain that countries pursue foreign direct investment to exploit comparative advantages, while firms seek control over resources and market access in order to reduce risks and competition.

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Building on these foundations, Dunning (1980) introduced the Eclectic Paradigm, or OLI Framework, which integrates ownership, location, and internalization advantages. This model highlights the importance of institutional quality, strategic management, and cultural factors in shaping foreign direct investment decisions. Strong institutions reduce uncertainty, enforce contracts, protect property rights, and limit corruption, which enhances a country's attractiveness to foreign investors. Firms are more likely to invest in regions with stable legal and political environments because of lower operational risks. Buckley and Casson (1976) emphasized the internalization benefits that multinational enterprises gain by reducing transaction and operational costs. Hennart (1982) similarly noted that multinational enterprises can more effectively utilize location-specific resources through direct investment. Rugman (1981) argued that despite globalization, many firms operate within regional clusters, highlighting the continuing importance of regional and institutional differences in shaping international strategies.

Empirical studies have examined the determinants of foreign direct investment across a wide range of countries. Ilhan (2007) identified market size, trade policy, financial systems, infrastructure, human capital, and political stability as key factors. Saini and Singhania (2018), analyzing data from 20 countries between 2004 and 2013 using the differenced generalized method of moments, grouped the drivers of foreign direct investment into economic, political, and institutional domains. Their results showed that trade openness positively influences foreign direct investment in both developed and developing economies. In developed economies, policy and institutional indicators had a stronger effect, while economic factors were more important in developing economies.

Walsh and Yu (2010) studied the determinants of foreign direct investment in 27 high and middle-income countries from 1985 to 2008, distinguishing between primary, secondary, and tertiary sectors. They considered macroeconomic variables including trade openness, exchange rates, GDP growth, inflation, and GDP per capita, along with qualitative factors such as labor market flexibility, infrastructure, financial depth, legal system efficiency, judicial independence, and education levels. Using a system generalized method of moments model to address endogeneity, they found strong correlations between macroeconomic indicators and overall foreign direct investment, with weaker associations for the primary sector. Foreign direct investment in the secondary sector was influenced by labor market flexibility and financial depth, while investment in the tertiary sector was driven by infrastructure and judicial independence (Ali et al., 2025; Aziz et al., 2025; Saim et al., 2025).

Asongu et al. (2018) focused on BRICS and MINT countries, analyzing data from 2001 to 2011 with a fixed effects model. They concluded that market size, trade openness, and infrastructure measured through mobile phone penetration were significant determinants of foreign direct investment, while institutional quality and natural resources were not. To address multicollinearity, they used principal component analysis to construct an institutional quality index from six correlated indicators.

Hintosova et al. (2018) investigated the determinants of foreign direct investment in the Visegrad countries of Poland, Hungary, the Czech Republic, and Slovakia between 1989 and 2016 using ordinary least squares and fixed effects models. They categorized determinants into economic factors such as factor prices, infrastructure, market size, location, and economic stability, social factors including cultural and linguistic proximity, and political factors such as stability, trade policies, and investment regulations. Their results indicated that market size, labor costs, education, trade openness, economic stability, innovation, and taxation were significant influences. Among these, wage levels and the proportion of educated labor had the most substantial positive effects, while corporate tax rates, domestic research and development spending, and trade openness had negative effects on foreign direct investment inflows.

THE MODEL

Building on prior research into the determinants of foreign direct investment, this study groups the relevant variables into three broad categories, which are economic, social, and institutional. For classification purposes, countries are divided into developed and developing economies using the World Bank Atlas method (Kang and Lee, 2021; Ali et al., 2025). According to this method, nations with a gross national income per capita below 12,535 United States dollars in 2019 are classified as developing, while those above this threshold are considered developed. This classification produces a sample of 178 countries, which allows for a comparative analysis across different levels of economic development. To examine the determinants of foreign direct investment inflows, the study adopts the following functional form:

$FDI_{it} = f(ECON_{it}, SOC_{it}, INS_{it})$

where i denotes country, t denotes time, FDI is the dependent variable, and ECON, SOC, and INS are economic, social, and institutional indices, respectively. This is transformed into a linear regression model using natural logarithms:

$$\ln FDI_{it} = \alpha_i + \beta_i \ln ECON_{it} + \gamma_i \ln SOC_{it} + \delta_i \ln INS_{it} + \varepsilon_{it}$$

where ε is a random error term.

The dataset spans 1996 to 2019, with sources specified for each variable. The dependent variable, FDI inflow, is obtained from UNCTAD and includes equity capital, reinvested earnings, and inter-company debt, measured in current US dollars. The study incorporates a set of economic, social, and institutional indicators to examine the determinants of foreign direct investment inflows. From the economic perspective, four key variables are selected from the World Bank's World Development Indicators. These include gross domestic product per capita, which serves as a proxy for market size, and trade openness, measured by the ratio of total exports and imports to gross domestic product. The contribution of natural resources to gross domestic product is used to represent factor prices, while the real effective exchange rate is considered an indicator of macroeconomic stability. Most economic variables are expected to positively influence foreign direct investment, although the impact of exchange rate fluctuations is more nuanced. If investment is market-oriented, currency

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appreciation may attract capital, whereas if it is cost-oriented and aimed at re-exporting, currency depreciation can reduce investment costs and encourage inflows (Ahmad et al., 2016; Chen et al., 2006; Lily et al., 2014).

Table 1: Variable Description

Category	Variable	Description	Source
Dependent variable	FDI	Inward FDI flow at current $ US$	UNCTAD
Economic	GDP	GDP per capita in current $ US$ (proxy for market size)	WDI
	Trade	The sum of total exports and imports as a share of GDP	WDI
	Factor	Share of natural resources in GDP (proxy for factor cost)	WDI
	Exchange	Real effective exchange rate (proxy for macroeconomic stability)	WDI
Social	Infrastructure	Mobile cellular subscriptions per 100 people (proxy for infrastructure quality)	WDI
	Human	Human capital index	Penn World
	Innovation	Domestic expenditure on R&D as a share of GDP	WDI
	Globalization	Social globalization index (0–100)	KOF Swiss Economic Institute
Institutional	Corruption	Control of Corruption	WGI
	Regulation	Regulatory Quality	WGI
	Political Stability	Political Stability and Absence of Violence	WGI
	Rule of Law	Rule of Law	WGI
	Accountability	Voice and Accountability	WGI
	Government	Government Effectiveness	WGI

The social dimension is captured through four indicators that reflect the broader socio-economic environment. Infrastructure quality is proxied by mobile cellular subscriptions per 100 people, reflecting technological accessibility and connectivity. Human capital is measured using an index based on years of schooling and the returns to education, obtained from the Penn World Table 9.0, indicating the skill level and productivity of the workforce. Innovation is represented by domestic expenditure on research and development as a percentage of gross domestic product, highlighting a nation's commitment to technological advancement. Globalization is assessed using the social globalization index developed by the KOF Swiss Economic Institute, which encompasses personal contacts, information flows, and cultural proximity. All four indicators are expected to positively influence foreign direct investment inflows, as they contribute to a conducive environment for business operations and international integration.

Although the broader concept of social capital could theoretically encompass these variables—drawing from foundational work by Hanifan (1916, 1920), Coleman (1988), and Putnam (1995)—the absence of comprehensive and comparable country-level indices limits its application in empirical cross-country analysis. Existing indices, such as those from the World Values Survey, the Global Social Capital Index, the Organisation for Economic Co-operation and Development, and Rupasingha et al., often have limited coverage or inconsistent methodologies, making them less suitable for long-term comparative studies.

The institutional dimension follows the frameworks of Buchanan et al. (2012), Dellis et al. (2017), and Asongu et al. (2018) and uses six governance indicators from the World Bank's Worldwide Governance Indicators, scaled from –2.5 for weak governance to +2.5 for strong governance. These include control of corruption, which reflects the extent to which public power is exercised for private gain; regulatory quality, which assesses the ability of the government to implement sound policies promoting private sector development; political stability and absence of violence, which measures the likelihood of unrest; rule of law, which captures adherence to societal rules; voice and accountability, which evaluates citizen participation and freedom of expression; and government effectiveness, which reflects the quality of public services and the independence of civil service from political pressures. All six are expected to positively influence foreign direct investment inflows by fostering stability, transparency, and efficiency in the investment climate.

RESULTS AND DISCUSSION

The findings from the pooled Ordinary Least Squares estimation, which incorporates both country-specific and time-specific effects, are presented in Table 1. Models 1, 2, and 3 correspond to the full sample, developed economies, and developing economies, respectively. The analysis shows that the social index consistently has a statistically significant and positive relationship with foreign direct investment inflows across all models. The strongest effect is observed in developed economies. This indicates that factors such as infrastructure quality, human capital, innovation capacity, and globalization—particularly cultural proximity—are central to attracting foreign investment. These findings are consistent with the theoretical view that strong social infrastructure lowers transaction costs and improves a country's appeal to investors by leveraging advanced human resources, as discussed by Coleman (1988) and Putnam (1995).

In contrast, the institutional index does not have a statistically significant impact on foreign direct investment inflows. The coefficients are positive for the total sample and developed economies, but slightly negative for developing

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economies. This explains that institutional factors such as regulatory quality, political stability, corruption control, and accountability may not be the main determinants of investment in developing regions. It is possible that in these markets, investors prioritize economic opportunities over institutional quality, or that the role of institutions differs according to regional and developmental contexts.

The economic index is positively and significantly associated with foreign direct investment inflows in developing economies, with significance at the 5 percent level. This underscores the importance of market size, trade openness, factor costs, and macroeconomic stability in influencing investment decisions in these regions. These results are in line with classical economic theories that highlight efficiency-seeking and resource acquisition as key motivations for investment in developing countries. The contrasting patterns between developed and developing economies may reflect the different nature of investment flows. Developed economies tend to attract horizontal foreign direct investment that focuses on market expansion, while developing economies are more likely to receive vertical investment aimed at resource extraction and cost efficiency, as noted by Dellis et al. (2017) and Saini and Singhania (2018).

Table 1: Pooled OLS Estimation

Variables	(1) Total	(2) Developed	(3) Developing
LECON	0.227	0.090	0.598**
	(0.201)	(0.259)	(0.269)
LSOC	0.937***	1.313***	1.251***
	(0.300)	(0.506)	(0.454)
LINS	0.128	0.352	-0.053
	(0.115)	(0.339)	(0.100)
Constant	-0.152	2.430	-3.832**
	(1.285)	(2.416)	(1.900)
R squared	0.814	0.759	0.929
F statistic	41.51	29.90	47.73

Note: 1) Country- and year-dummies are controlled.
2) Standard errors in parentheses ***p < 0.01, **p < 0.05, *p < 0.1.

To further validate the model, fixed effects and random effects estimations are conducted, with results presented in Table 2. Models 4, 5, and 6 represent the total sample, developed economies, and developing economies, respectively. The Breusch–Pagan LM test and the Hausman test are applied to determine the most appropriate model specification. The Hausman test produces p-values low enough to reject the null hypothesis in Models 4 and 6, indicating that the fixed effects model is more suitable in these cases. In contrast, Model 5 records a p-value greater than 0.05 ($\chi^2(3) = 3.94$, $p > \chi^2 = 0.268$), which explains that the random effects model is preferable for developed economies. In contrast to the pooled Ordinary Least Squares results, the fixed and random effects estimations show that the economic index is positively and significantly associated with foreign direct investment inflows across all models, except for the fixed effects estimation for developed economies. Notably, the coefficient for the economic index in developing economies is considerably higher and more statistically significant than in the Ordinary Least Squares model. This outcome reinforces the predictions of classical international business theories and supports earlier empirical studies.

Table 2: Fixed and Random Effects Estimation

Variables	(4) Total		(5) Developed		(6) Developing	
	FE	RE	FE	RE	FE	RE
LECON	0.409**	0.582***	0.310	0.445**	0.741***	1.064***
	(0.170)	(0.136)	(0.209)	(0.187)	(0.247)	(0.229)
LSOC	0.972***	0.772***	1.253***	1.083***	0.358	0.034
	(0.219)	(0.193)	(0.290)	(0.270)	(0.275)	(0.262)
LINS	0.0535	-0.006	0.129	0.180	-0.073	-0.115
	(0.117)	(0.101)	(0.326)	(0.252)	(0.0952)	(0.0934)
Constant	0.687	-0.054	0.323	-0.389	0.550	-0.561
	(0.913)	(0.742)	(1.209)	(1.103)	(1.028)	(0.960)
LM test: $\chi^2(1)$		2547.96		1875.59		280.23
Hausman: $\chi^2(3)$	8.91		3.94		11.07	

Note: Standard errors in parentheses ***p < 0.01, **p < 0.05, *p < 0.1.

While the social index shows a consistently significant positive effect on foreign direct investment in the Ordinary Least Squares estimations, its influence becomes statistically insignificant in the fixed effects model for developing economies, as reflected in Model 6. This explains that in these regions, foreign investment is more strongly influenced by economic fundamentals rather than by social or institutional characteristics. It further implies that social indicators, including infrastructure, human capital, innovation, and globalization, may exert a greater influence during the later stages of investment. The concept of social capital, as discussed by Coleman (1988), Putnam (1995), Inkpen and Tsang (2005), and Beugelsdijk and Smulders (2009), supports this interpretation by emphasizing that improved social infrastructure reduces transaction costs and enhances a country's attractiveness to foreign investors. Walsh and Yu (2010) similarly found that social development indicators such as school enrollment and financial depth significantly affect foreign direct investment in the secondary and tertiary sectors, although not in the primary sector. Despite a substantial body of literature

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reporting a positive and significant relationship between institutional quality and foreign direct investment inflows, the results of this analysis do not confirm such an association. Institutional indicators are found to be statistically insignificant and, in some cases, negatively correlated with foreign direct investment in developing economies. This outcome runs counter to the expectations of the Eclectic Paradigm and diverges from the results of Buchanan et al. (2012) and Dellis et al. (2017), who observed a positive relationship between institutional quality and foreign direct investment in global and Eurozone contexts.

However, the findings align with those of Asongu et al. (2018), who reported that institutional quality does not significantly influence foreign direct investment in fast-growing developing countries such as those in the BRICS and MINT groups. Similarly, Peres et al. (2017) found a positive association between institutional quality and foreign direct investment in developed countries, but no significant effect in developing nations. These contrasting results illustrate the complexity of foreign direct investment behavior and explain that institutional factors may have different degrees of influence depending on regional, temporal, and methodological contexts.

Table 3: Estimation Results Using Individual Indicators

Variables	OLS	FE	RE
GDP	0.306	0.682***	0.847***
	(0.325)	(0.223)	(0.185)
Trade	-0.390	0.049	-0.075
	(0.281)	(0.256)	(0.188)
Factor	0.041	0.194	0.221*
	(0.178)	(0.169)	(0.129)
Exchange	-0.693	-0.747*	-0.997***
	(0.445)	(0.399)	(0.350)
Infrastructure	0.204	0.304***	0.276***
	(0.124)	(0.080)	(0.071)
Human	2.978*	1.555	2.159**
	(1.522)	(1.403)	(1.101)
Innovation	-0.190	-0.470	-0.040
	(0.408)	(0.393)	(0.315)
Globalization	-0.048	-1.162	-1.980*
	(1.222)	(1.177)	(1.032)
Accountability	-0.164	-0.155	-0.125
	(0.163)	(0.166)	(0.152)
Political Stability	0.108	0.170	0.042
	(0.132)	(0.136)	(0.116)
Government	-0.242	-0.477*	-0.171
	(0.259)	(0.263)	(0.236)
Regulation	0.635*	0.378	0.725**
	(0.379)	(0.387)	(0.345)
Rule of Law	-0.124	-0.293	-0.279
	(0.323)	(0.326)	(0.272)
Corruption	0.130	0.224	0.167
	(0.140)	(0.143)	(0.139)
Constant	2.689	7.225*	9.355***
	(5.101)	(4.275)	(3.566)

Note: Standard errors in parentheses ***p < 0.01, **p < 0.05, *p < 0.1.

To validate the robustness of these findings, the study conducts a detailed examination of all fourteen individual indicators that comprise the economic, social, and institutional indices. The results are presented in Tables 3 and 4. In Table 3, among the four economic indicators, gross domestic product and the factor variable both display positive and statistically significant coefficients in the fixed and random effects models. Specifically, the fixed effects model shows that a one-unit increase in the share of natural resources in gross domestic product leads to a 0.221 unit increase in foreign direct investment inflows, holding all other variables constant. These results explain that countries generally rely on market size and resource availability to attract foreign investment. This finding is consistent with the broader literature on market-seeking foreign direct investment, as discussed by Islan and Beloucif (2023). In contrast, the exchange rate variable exhibits a negative and statistically significant relationship with foreign direct investment in both fixed and random effects models, with significance levels of ten percent and one percent, respectively. This negative coefficient indicates that currency appreciation in the host country tends to encourage foreign direct investment from market-oriented firms. This observation aligns with empirical evidence reported by Chen et al. (2006), Lily et al. (2014), and Wang and Wei (2017).

Further analysis of the individual variables offers more nuanced insights into the determinants of foreign direct investment inflows. Among the four social indicators, both infrastructure and human capital variables display positive and statistically significant coefficients in multiple models. Infrastructure is significant in both fixed and random effects estimations, while

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human capital is significant in the Ordinary Least Squares and random effects models. These findings underscore the importance of technological accessibility and education in attracting foreign investment across different country contexts. However, the globalization variable, as estimated in the random effects model, shows a negative and statistically significant relationship at the ten percent level. This result explains that certain aspects of social globalization, such as personal contacts, information flows, and cultural proximity, may act as deterrents to foreign direct investment inflows (Zahid, 2018; Bashir & Bashir, 2019; Ali et al., 2025). This could be due to increased operational complexity or the presence of cultural barriers that make entry and integration more challenging for foreign firms. Within the institutional category, the regulation variable demonstrates a positive and statistically significant impact in the Ordinary Least Squares and random effects models. This finding indicates that sound policy frameworks that support private sector development tend to be favorable for attracting foreign investment (Iqbal & Raza, 2018; Perveez, 2019; Nwosu & Folarin, 2025). Conversely, the government effectiveness variable shows a negative and statistically significant coefficient in the fixed effects model. This result implies that the quality and independence of public services may not necessarily promote foreign investment, possibly due to bureaucratic inefficiencies or overly rigid administrative structures that hinder flexibility for foreign enterprises.

Table 4: Estimation Results Using Individual Indicators

Variables	Developed			Developing		
	OLS	FE	RE	OLS	FE	RE
GDP	0.367 (0.425)	0.781*** (0.296)	0.844*** (0.266)	0.285 (0.440)	0.489 (0.315)	0.857*** (0.271)
Trade	-1.123** (0.456)	-0.187 (0.417)	-0.064 (0.265)	0.043 (0.330)	-0.025 (0.311)	-0.230 (0.281)
Factor	0.286 (0.271)	0.556** (0.252)	0.310 (0.193)	-0.524** (0.205)	-0.128 (0.184)	0.104 (0.155)
Exchange	-0.838 (0.590)	-0.967* (0.515)	-0.963** (0.482)	-0.671 (0.617)	-0.180 (0.541)	-0.702 (0.470)
Infrastructure	0.137 (0.189)	0.305*** (0.105)	0.312*** (0.100)	0.626*** (0.155)	0.296*** (0.104)	0.249*** (0.096)
Human	2.299 (1.929)	1.117 (1.735)	1.496 (1.485)	6.638*** (2.385)	3.043 (2.295)	4.155*** (1.579)
Innovation	-0.185 (0.531)	-0.520 (0.518)	-0.230 (0.405)	-1.126* (0.619)	-0.873 (0.572)	0.085 (0.524)
Globalization	1.897 (1.994)	-0.242 (1.875)	-1.571 (1.752)	-2.108 (1.795)	-1.093 (1.629)	-2.686* (1.388)
Accountability	0.545 (0.663)	-0.384 (0.656)	-0.732 (0.558)	-0.267** (0.127)	-0.207 (0.127)	-0.151 (0.125)
Political Stability	0.494 (0.305)	0.561* (0.300)	0.200 (0.256)	-0.041 (0.105)	0.037 (0.107)	-0.028 (0.099)
Government	1.031 (0.646)	0.448 (0.647)	0.571 (0.629)	-0.503** (0.213)	-0.822*** (0.208)	-0.587*** (0.197)
Regulation	0.113 (0.618)	0.076 (0.627)	0.382 (0.600)	0.856** (0.388)	0.697* (0.394)	0.980*** (0.345)
Rule of Law	-1.575** (0.740)	-1.189 (0.754)	-0.879 (0.729)	0.322 (0.292)	-0.236 (0.276)	-0.219 (0.236)
Corruption	0.527 (0.558)	0.662 (0.563)	0.564 (0.517)	0.216** (0.107)	0.289*** (0.105)	0.223** (0.106)
Constant	-0.232 (8.760)	4.773 (6.836)	8.520 (6.383)	4.979 (5.794)	4.284 (4.734)	9.077** (4.100)

Note: Standard errors in parentheses ***p < 0.01, **p < 0.05, *p < 0.1.

Table 4 extends the analysis by separating the sample into developed and developing economies. In line with earlier results, gross domestic product continues to be a positive and statistically significant determinant of foreign direct investment in both groups of countries. This reinforces the view that market size remains a central driver of investment decisions regardless of the stage of economic development (Diaz & Collin, 2025l; Iqbal & Hayat, 2025). The factor variable, however, produces mixed outcomes. For developed economies, it is positively and significantly associated with foreign direct investment in the fixed effects model. This indicates that resource abundance can serve as an additional incentive for investors in advanced markets, where extraction and utilization are often supported by strong infrastructure, advanced technology, and effective regulatory frameworks. In contrast, the factor variable is negatively and significantly related to foreign direct investment in the Ordinary Least Squares model for developing economies. This explains that resource abundance may discourage foreign investors in these contexts, potentially due to concerns about over-reliance on extractive industries, vulnerability to commodity price fluctuations, or governance challenges commonly associated with resource-dependent economies (Marc, 2025). This finding resonates with the “resource curse” hypothesis, which

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argues that abundant natural resources can be linked to weaker institutions, reduced economic diversification, and lower long-term growth prospects, thereby diminishing the appeal of such economies to certain categories of investors.

The exchange rate variable is negatively significant only in the fixed and random effects models for developed economies. This reinforces the view that foreign direct investment in these regions is predominantly market-oriented and horizontal in nature, targeting access to consumer markets rather than cost efficiencies. In contrast, foreign direct investment in developing economies is often cost-driven and vertical, with a primary focus on resource extraction and efficiency gains, as noted by Dellis et al. (2017) and Saini and Singhania (2018). In terms of social indicators, the infrastructure variable retains a positive and statistically significant effect in both developed and developing economies. This is consistent with the results of Asongu et al. (2018) and Asiamah et al. (2019), who identified infrastructure quality as a critical determinant of investment attractiveness across different economic contexts. Human capital is significant only in the Ordinary Least Squares and random effects models for developing economies, indicating that education and skills development play a particularly important role in attracting foreign direct investment to these regions. This finding aligns with Hintošová et al. (2018), who demonstrated that a higher share of educated labor positively influences foreign direct investment inflows in the Visegrad countries.

The innovation and globalization variables produce negative and statistically significant coefficients in the Ordinary Least Squares and random effects models for developing economies, respectively. This explains that domestic research and development expenditure, as well as certain aspects of social globalization, may not be conducive to attracting investment in these contexts. Potential explanations include inefficiencies within innovation systems and the possibility that increased cultural and informational exchange introduces complexities or barriers that deter foreign investors. Hintošová et al. (2018) similarly reported a negative relationship between research and development spending and foreign direct investment inflows in the Visegrad region. Among the six institutional indicators, the government effectiveness and regulatory quality variables show contrasting results in developing economies. Government effectiveness has a negative and significant coefficient, explaining that perceptions of administrative rigidity or inefficiency may deter investors. In contrast, regulatory quality demonstrates a positive and significant relationship, implying that clear and supportive policy frameworks remain a draw for foreign capital. Furthermore, political stability and rule of law emerge as significant determinants in developed economies, while voice and accountability, along with control of corruption, are significant in developing economies. These results imply that in advanced economies, investors place greater emphasis on stability and legal reliability, whereas in developing economies, concerns about corruption and governance transparency are more influential, even in settings where freedom of expression and media independence are less robust.

CONCLUSION

Foreign direct investment is widely recognized as a catalyst for economic development through its contributions to capital formation, employment generation, technological advancement, and productivity growth in host countries. This study examines the determinants of foreign direct investment inflows with particular attention to the differences between developed and developing economies. The results show that developing economies rely heavily on economic fundamentals such as market size, trade openness, factor costs, and macroeconomic stability to attract foreign investment. In contrast, developed economies exhibit a stronger association between foreign direct investment inflows and social indicators, including infrastructure quality, human capital, innovation capacity, and cultural integration. Across both groups, institutional indicators display a weak and statistically insignificant relationship with foreign direct investment inflows, suggesting that governance and regulatory quality may play a more limited role than commonly assumed.

Pooled ordinary least squares estimations, incorporating both country and year fixed effects, reveal that the social index is positively and significantly correlated with foreign direct investment in both developed and developing economies, with a more pronounced effect in developed countries. The economic index is positively significant in developing economies, while the institutional index remains insignificant in all cases. Fixed and random effects models reinforce the importance of economic indicators across most specifications, except for the fixed effects model in developed economies. The significance of the social index diminishes in developing economies under these models, indicating that economic fundamentals may drive initial investment decisions, whereas social factors may become more relevant as investment relationships mature. From a policy perspective, developing countries should focus on expanding market size, integrating into global trade networks, improving cost competitiveness, and ensuring macroeconomic stability, as reflected in indicators such as gross domestic product, trade volumes, factor prices, and exchange rates. Developed economies, on the other hand, should prioritize enhancing infrastructure, education, research and development, and cultural openness, measured through schooling years, mobile connectivity, innovation expenditure, and globalization indices. Tailoring strategies to these distinct priorities can help countries create more attractive investment environments, strengthen their global competitiveness, and foster sustainable economic growth.

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