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The Determinants of FDI in Landlocked Developing Countries in Central Asia

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Introduction

- **Foreign direct investment (FDI)** helps accelerate development and reduce poverty through employment, transfer of technologies and business processes, knowledge of export markets, and transfers of capital.
- FDI can also play a pivotal role in providing infrastructure, such as transport, utilities, and telecommunications, where there is insufficient local factor endowment (UNCTAD, 2009).

- Analyzing FDI flows to **LLDCs in Central Asia is important for several** reasons.

1. FDI inflow to eight Central Asian countries (a unique geopolitical context).
2. Insufficient empirical analysis - investigating the importance of FDI determinants in LLDCs in Central Asia.
3. Econometric analysis

   – clarify the key factors that can be used by countries wishing to attract more foreign investment

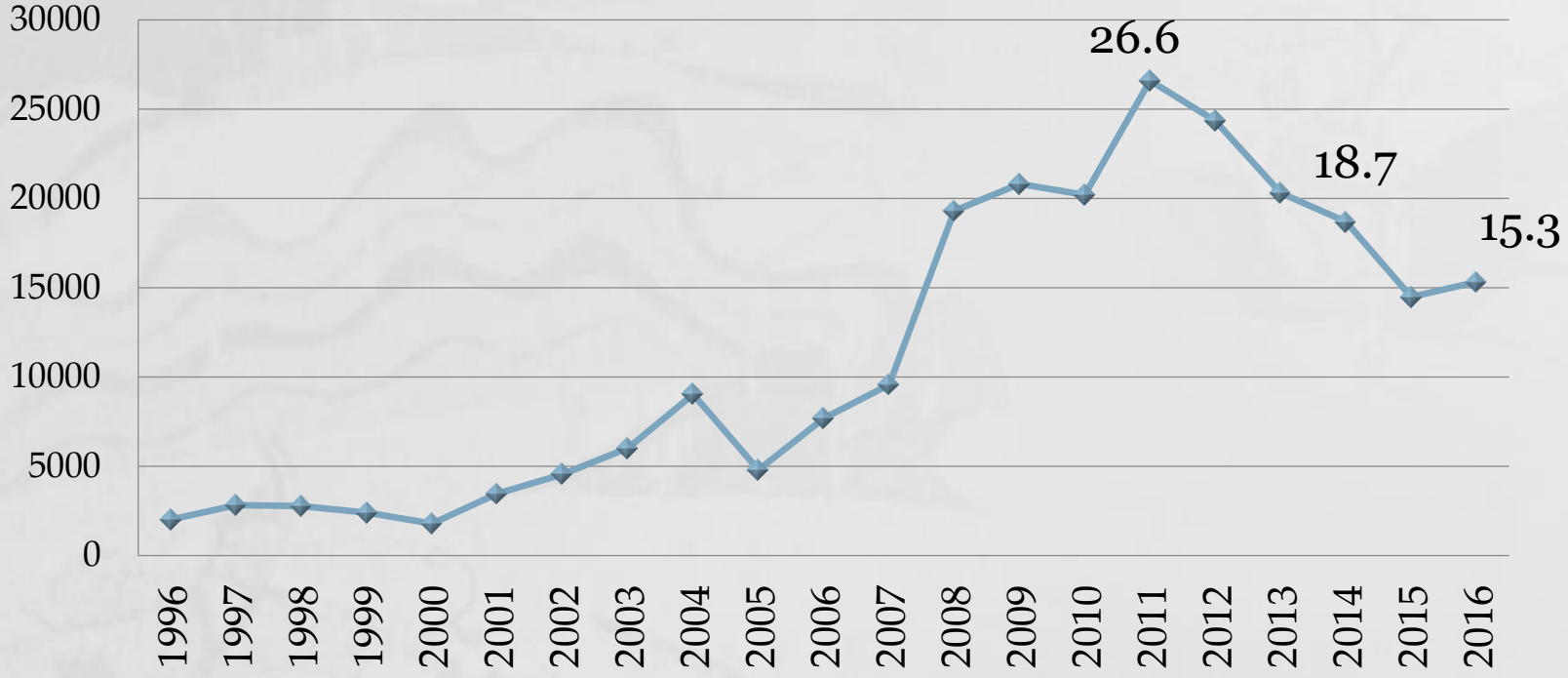
   – provide proper indications for policy implications for those countries.

Literature Review

- A number of studies have been conducted to investigate the determinants of FDI to different regions - Asia, Southeast Asia; Central and Eastern Europe; Eurasian transition economies; Southeast Europe.
- FDI flows to mineral-resource-rich LLDCs in Central Asia – hardly to find.
  - Previous studies on the determinants of FDI into LLDCs in Central Asia lack empirical analysis
  - and have not closely investigated the factors affecting FDI in Central Asian LLDCs or on some single countries only.
  - The results in the literature are ambiguous in defining the relationship between FDI and other explanatory variables.
- However, the purpose of the present research is not to establish which results are inconclusive.
- *Rather, it seeks to evaluate the extent to which the variables are included in the existing works and to analyze the impact on FDI to LLDCs in Central Asia.*

FDI in Central Asian LLDCs: Stylized Facts

FDI inflows to eight Central Asian LLDCs (millions of dollars,) 1996– 2016



Source: Author's compilation. UNCTAD, FDI database at http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx

FDI in Central Asian LLDCs: Stylized Facts

FDI inflows to eight Central Asian LLDCs, to other country groupings

Country groupings	FDI inflows ($ million, 2016)	Percentage of total world (%, 2016)	FDI stock as a % of GDP (2016)	FDI inflows as share of GFCF (%, 2015)	FDI inflows per capita (2016, $)	Annual av. of FDI inflows ($ million, 1996–2016)	Annual av. growth rate of FDI inflows (%, 1996–2016)
World	1 746 423	100.0	35.1	9.6	236	1 222 220	7.5
Developed economies	1 032 373	55.4	38.2	11.8	984	729 064	7.4
Developing economies	646 030	42.4	30.2	8.2	107	447 582	7.4
LDCs	37 944	2.4	33.4	17.9	39	24 052	13.9
LLDCs	24 326	1.4	49.4	12.8	50	17 541	9.8
LLDCs (CA-8)	15 325	**0.8**	**67.9**	18.3	85	11 851	11.2

Source: Author's compilation. UNCTAD, FDI database at http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx

GFCF :gross fixed capital formation

Variables and Data

- The choices of explanatory variables in the study are based on a number of previous conceptual and empirical studies in the literature, such as:
  - GDP per capita, Infrastructure quality, Trade openness, Corporate tax rate, Inflation rate, Quality of governance, Import tariff rate, Business freedom,

- The best compiled and most advanced research on the determinants of foreign investment in this sector was conducted by Otto (1998) and Otto et al. (2007).
- Otto divides the investment criteria into nine principal categories, which also includes additional criteria identified by Morisset (2000), Kasatuka and Minnit (2006), Penney et al. (2007), and Tole and Koop (2011).

Empirical Results

- The purpose of the study is to shed some light on why mineral-resource-rich LLDCs in Central Asia are less attractive than other regions for foreign investors and what the main factors limiting FDI are.
- Similar to the existing literature, this study finds that a higher return on capital, openness, and good quality of infrastructure promotes FDI in LLDCs in Central Asia.
- As expected, a decline in corruption has a positive effect on FDI, while regulatory quality and degree of business freedom have insignificant impacts on investment.

Empirical Results

- One of the interesting result : The governance indicators show positive evidence.
- Specifically, the result for political instability presents consistent positive effects—suggesting that an unstable political situation encourages the flow of FDI and generates more investment in LLDCs in Central Asia.
- Nonetheless, political instability threatens investment; investors sometimes consider political instability as a good sign. Many historical cases show these kinds of examples, especially in developing and mineral-resource- rich regions of the world.
- Politically unstable countries are likely to have a weak and inefficient decision-making process, which would eventually attract investors trying to seize opportunities.
- Several studies also find that politically unstable countries attract capital flows from developed countries with high political stability.

Conclusion

- The results show that political instability, corporate tax rate, and **inflation rate do not always lead to less FDI flow.**
- **However, this finding does** not mean that countries should promote an unstable political and economic situation in order to accelerate and boost investment flows in their countries.
- In this case, I suggest that host countries need to pay more attention to how to improve the quality of governance and economic situation by attracting foreign investment.

Thank you!