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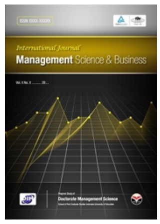

Does The Effects of Corruption on Foreign Direct Investments in Developed and Developing Countries

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A B S T R A C T

This study investigates the impact of corruption on foreign direct investment (FDI) in both developed and developing countries by analyzing how perceived levels of corruption influence investment inflows as a percentage of GDP. Using panel data from 2016 to 2023 across selected countries, the research employs multiple linear regression models to examine the relationship between the Corruption Perception Index (CPI Score) and FDI_GDP. The findings reveal significant differences between country groups: in developing countries, lower CPI scores (indicating higher corruption) are often associated with higher FDI inflows, suggesting that foreign investors may tolerate or even adapt to corrupt environments in pursuit of market opportunities. In contrast, developed countries exhibit relatively stable FDI flows and higher CPI scores, reflecting stronger governance and transparency. The study also reviews prior research, including the Tolerable Level of Corruption Index (TLCI) by Abotsi (2018) and panel model analysis by Bellos and Subasat (2012), to contextualize the varying effects of corruption on investment behavior. The results underscore the importance of institutional quality, political stability, and tailored policy strategies in attracting sustainable foreign investment

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1. INTRODUCTION

The impact of corruption on economic growth remains one of the most pressing issues in economic research. According to international country risk guidelines (ICRG, 2006), corruption is suggested to restrict economic growth by negatively influencing investment in physical capital, human capital development, and political stability. High levels of corruption are usually linked to weak governance systems, which impede effective budgetary management and pose significant threats to political stability and economic growth. Corruption has several facets, including philosophical, legal, cultural, and economic. Its definition may vary depending on the approach of the study being conducted. As noted by Tomaszewski (2018), industrialized and democratic countries tend to have different cultural attitudes and perspectives towards corruption compared to other economies.

According to this study, corruption is the behavior of public servants who break the law for their own benefit, harming society in the process. Increased inequality, heightened unfairness, institutional deterioration, a drop in public confidence in political systems, and a reduction in economic efficiency are all consequences of corruption.

Important questions come up from an economic standpoint: Can the slowdown in economic growth be attributed in part to high levels of corruption? Does the size of the government hinder the level of economic activity or growth? Are there transmission channels through which corruption affects the economy? The literature is divided on the causes of corruption and how it affects economic activity, despite a number of findings. However, governments and international organizations have paid close attention to the consequences of corruption. In response, many countries have developed governance indicators and introduced specific laws and regulations to regulate the behavior of public and private agents (Bação et al., 2019).

Recent studies have provided additional insights into the relationship between FDI and the environment. For example, Wang et al. (2023a, b, c) discovered that FDI leads to increased environmental deterioration in developing European nations over time, validating the PHH. However, Xie et al. (2023) found an inverted U-shaped association between FDI and pollution in China, showing that the influence switches from positive to negative as FDI levels rise. As a logical consequence, the two opposite effects may necessarily imply a nonlinear association between the FDI and the environment, in a relationship similar to the hypothetical environmental Kuznets curve (EKC), which links GDP with the environmental situation (Ayad et al., 2023; Djedaiet, 2023; Usman & Jahanger, 2021). This study intends to highlight how a lack of funding impedes growth in the Sub-Saharan African region. The region's governments have a hard time attracting effective sources of financial instruments to support and enhance regional economic activity. This situation continues to expand the poverty and inequality gaps in the region, especially in these perilous times where the global pandemic (COVID-19), coupled with the political instability in Europe, has 62 T. F. Alhassan et al. / Russian Journal of Economics 10 (2024) 60−83 undermined economic cooperation among countries.

Abotsi (2018) examined the Tolerable Level of Corruption (TLC) in relation to foreign direct investment (FDI) and developed the Tolerable Level of Corruption Index (TLCI) to compare Asia and Europe with Africa. The findings indicated that countries across all three continents implement measures to combat corruption as a strategy to maintain investment inflows. However, in the case of African nations, it was emphasized that beyond addressing corruption, they must also manage political factors to effectively attract and retain FDI.

In a separate study, Bellos and Subasat (2012) analyzed the correlation between corruption and FDI using a panel severity model across fifteen transitional economies. Their research found a positive association between the volume of FDI and the level of corruption. Specifically, in less democratic and less economically developed countries, higher corruption levels were linked to greater inflows of FDI. The authors suggest that in such environments, both foreign and domestic firms are often engaged in bribery to secure government contracts, thereby reinforcing the cycle of corruption through their investment activities.

Therefore, this article aims to explore the relationship between FDI inflows and corruption in different countries. Specifically, this study will address the following research question How does the level of perceived corruption, measured by the CPI Score, influence foreign direct investment as a share of GDP?

Several studies support the helping hand theory suggesting that high levels of corruption can increase FDI inflows (B. A. Karim et al., 2018; Belloumi & Alshehry, 2021; Jan et al., 2019 Krifa Schneider et al., 2022; Moustafa, 2021; Onody et al., 2022). Helmy (2013) investigated the impact of corruption on investment inflows in MENA countries from 2003 to 2009 using the panel Generalized Least Square (GLS) method. The results showed that corruption does not reduce but increases FDI inflows in MENA countries. Employing the GMM method for 53 countries in Africa, Quazi et al. Degong et al. (2023) found that in the short run exchange rate, inflation, and corruption significantly affect FDI in a negative direction, while exports do not significantly affect FDI. Kim & An (2022) found that the relationship of e-government to FDI will be stronger when the recipient country is more corrupt. Khalid (2024) noted that countries with elevated levels of corruption may initially facilitate FDI. Foreign Direct Investment (FDI) is affected by a range of macroeconomic factors specific to each country. This study seeks to analyze the determinants of FDI in D8 member countries from 2017 to 2022, incorporating the Corruption Perception Index as a moderating variable. The contribution of this research to previous research is to add export variables in the dependent variable as a research novelty. In addition to fostering international trade by providing access to foreign markets, FDI also serves as a conduit for technology transfer between nations, thereby contributing to economic development. (OECD iLibrary, 2023).

Corruption refers to the abuse of power for private benefit (Marchini et al., 2019). Corruption manifests in various forms, including bribery, abuse of office and trading in influence. It takes place through several channels, such as theft and embezzlement, bribes and kickbacks, money laundering and other illicit financial flows and state capture (Hope, 2021; Hope, 2020). Corruption can be perceived from two perspectives: public and private. While public corruption relates to the use of public office for private gains, private corruption refers to the deliberate violation of legal regulations by an organization for personal gain at the detriment of the corporate objectives. The literature provides several measurements of corruption. One of the most widely recognized measures is corruption perception index (CPI). The CPI is a governance indicator compiled by World Bank that ranks countries by their corruption levels. According to Baumann (2019, p. 2), CPI:

The economy of Sub-Saharan Africa is seen to be experiencing its slowest growth and greatest recession since the 1960s, as output declined by close to 2.5% in 2020 due to the COVID-19 pandemic (World Bank, 2021). The trend of economic growth in Sub-Saharan Africa is presented in Fig. 1. The slowdown of economic growth in these countries has derailed the successes gained through the implementation of previous development programs. It is estimated that the region is growing slightly higher than projected, thus making the effects of the pandemic milder than expected. The growth is attributed to the positive spill-over effects of the consolidation of world economic performance and the rise in oil and mineral prices. However, the pandemic has exacerbated budget constraints in the region, which has always remained the major challenge for Sub-Saharan African countries, by widening budget deficits and increasing government borrowings. Regarding the relationship between the Sustainable Development Index (SDI), corruption and income inequality, it is important to emphasize that institutional integrity and economic disparity directly impact sustainability. Corruption can hinder sustainable development (Dinca et al., 2021) by reducing the effectiveness of institutions and misallocating resources. On the other hand, income inequality can foster social

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problems, affecting social stability, which is a crucial aspect of sustainable development (Tutar and Atas, 2022). These issues are critical as they influence the economic, social and environmental aspects that SDI considers. Thus, a higher SDI score would imply not only better human development and lesser environmental impact but also lower corruption and income inequality

2. METHOD

This study adopts a quantitative research design to systematically investigate the relationship between corruption the foreign direct investment (FDI) inflows across a selection of both developed and developing countries. The objective is to determine how varying levels of corruption influence the scale and stability of forign investment, using empirical data to quantify these effects. The primary research question explores the impact of corruption on foreign investment by analyzing the relationship between key indicators; FDI as a percentage of GDP (FDI_GDP) and the corruption Perceptions Index CPI score). These indicators serve as proxies for investment activity and corruption levels, respectively. A total of 19 countries – strategically selected to ensure a balanced representation of different economic and governance structures – from the basis of this analysis. To evaluate these relationship, the study employs a multiple linear regression model, which enables the estimation of both cross – sectional and time-series effects. This method accounts for variations across countries and over time, thereby providing a robust framework for inference. The panel dataset spans a period of eight years (2016-2023), allowing for identification of trends, patterns, and potential shifts in the interaction between corruption and FDI over time.

Data for this research are obtained from credible and publicly accessible databases. FDI-GDP indicators are sourced from the World Bank's World Development Indicators, while corruption metrics are drawn from Transparency International, a globally recognized organization committed to monitoring and combating corruption. These sources ensure data reliability and international comparability. By integrating these quantitative methods with reliable data, the study aims to contribute meaningful insights into the policy implications of corruption control and its potential to enhance foreign investment inflows, particularly in economies where institutional is a key determinant of investor confidence.

3. RESULTS AND DISCUSSION

According **Country-Level Regression Analysis: FDI_GDP vs CPI Score**

This document presents the results of individual linear regressions for each country, analyzing the impact of the Corruption Perception Index (CPI_Score) on Foreign Direct Investment as a percentage of GDP (FDI_GDP). The table below includes the regression coefficient, p-value, and R-squared for each country.

Country	Coefficient	p-value	R-squared
Uzbekistan	0.3842	0.0007	0.8714
Nigeria	0.0629	0.0037	0.7788
Senegal	-0.4767	0.0142	0.6608
Indonesia	0.1078	0.0349	0.5511

Country	Coefficient	p-value	R-squared
Cambodia	-0.7071	0.0941	0.3969
Pakistan	0.0485	0.1120	0.3661
Nepal	-0.0875	0.1435	0.3206
South Africa	-0.2532	0.1466	0.3165
Philippines	0.2200	0.2474	0.2149
Kenya	-0.0352	0.2772	0.1922
Vietnam	-0.2195	0.2939	0.1806
Egypt	0.2503	0.3119	0.1689
India	0.1609	0.3831	0.1286
Ethiopia	-0.1173	0.4012	0.1197
Ghana	-0.4218	0.4717	0.0895
Sri Lanka	0.0882	0.5123	0.0748
Morocco	0.0346	0.8021	0.0113
Tanzania	-0.0143	0.8641	0.0053
Uganda	0.0340	0.9007	0.0028

Here is the country-by-country regression analysis of how the Corruption Perception Index (CPI_Score) affects FDI as a percentage of GDP (FDI_GDP). There is:

- Coefficient (coef)**:** how much FDI_GDP changes with a 1-unit change in CPI_Score.
- p-value: indicates if the relationship is statistically significant.
- R-squared**: s**hows how well CPI_Score explains variations in FDI_GDP.

This section presents the findings of country-level linear regressions examining the impact of the Corruption Perceptions Index (CPI_Score) on Foreign Direct Investment as a percentage of GDP (FDI_GDP). The coefficients, p-values, and R-squared values for each country reflect the strength, direction, and statistical significance of this relationship.

General Findings: Countries with Insignificant Results

Several countries show statistically insignificant results ($p > 0.05$) and low R^2 values, such as,

India ($p = 0.3831$, $R^2 = 0.1286$), South Africa ($p = 0.1466$, $R^2 = 0.3165$), Philippines ($p = 0.2474$, $R^2 = 0.2149$)**,** Egypt, Morocco, Sri Lanka, and Tanzania — all showing weak or near-zero correlations.

These findings suggest that in these economies, CPI_Score does not play a strong role in influencing FDI inflows, and other structural, political, or economic variables likely dominate the decision-making process of foreign investors.

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Mixed and Negative Associations

Countries such as Vietnam (-0.2195), Ghana (-0.4218), and Ethiopia (-0.1173) also exhibit negative coefficients with low R^2 values. While these results are not statistically significant, they underscore the complex and potentially non-linear relationship between governance quality and investment attractiveness. In countries where institutions are still developing, other factors such as resource availability, labor costs, or political incentives might override the impact of corruption perception.

The regression results highlight that the relationship between CPI Score and FDI_GDP is not uniform across countries. While some countries — notably Uzbekistan and Nigeria — exhibit strong and positive associations, others display weak or inverse relationships. This suggests that corruption perception alone cannot fully explain FDI trends and that country-specific economic, legal, and geopolitical factors must be considered in comprehensive FDI analysis. Therefore, policy reforms targeting transparency and anti-corruption may enhance FDI in some countries, but such initiatives must be accompanied by broader economic and institutional improvements to be effective.

4. CONCLUSION

This study explored the relationship between the Corruption Perceptions Index (CPI_Score) and Foreign Direct Investment as a share of GDP (FDI_GDP) using country-level regression analysis across 19 countries for the period 2016–2023. The findings suggest that the link between perceived corruption and FDI inflows is complex, non-linear, and significantly influenced by country-specific contexts. While countries like Uzbekistan, Nigeria, and Indonesia show a statistically significant and positive relationship between improved CPI scores and higher FDI inflows, others like Senegal and Cambodia show negative relationships, indicating that less corruption does not universally translate into more foreign investment. In many cases, especially in large or developing economies such as India, South Africa, and Egypt, CPI_Score was not a significant determinant of FDI inflows, with low explanatory power in the regression models.

These results imply that corruption perception alone is not a sufficient predictor of FDI attractiveness. Foreign investors often consider a broader set of economic, regulatory, and geopolitical variables, such as market size, labor force, trade openness, legal enforcement, and political stability. Therefore, while anti-corruption reforms are essential for improving institutional quality and long-term investment climate, they must be accompanied by holistic economic reforms and improved ease of doing business to effectively attract sustainable foreign investment. The analysis also underlines the importance of tailoring policy approaches to national contexts. A one-size-fits-all strategy in addressing corruption and attracting FDI may not yield the desired outcomes. Policymakers should thus focus on integrated investment strategies that align governance improvements with broader development goals.

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