ABSTRACT

This paper aims to examine the determinant of Foreign Direct Investment (FDI) in Emerging Market Countries (EMC) starting from 1988 to 2018, specifically the shadow economy. The error-correction model (ECM) is applied to estimate the dynamic panel data in the short-run estimation and for the long-run this study applied ordinary panel data model. This study found that shadow economy has a significantly negative effect on FDI inward both in the long-run and for the short-run only in the pre-crisis period. In addition, economic growth, trade openness, policy rate, and infrastructure have various significant roles to FDI inward in the short-run during pre-crisis, post-crisis, and in all periods. Moreover, population also significantly affects FDI in the short-run for the thirty-one years observation. For the long-run, economic growth, policy rate, inflation, and HDI found to be significant in the estimation. Only exchange rate, as one of efficiency-seeking motives and macroeconomic factors, has no significant role to FDI in EMC. This analysis suggests policymakers in EMC to consider shadow economy along with investor motives and macroeconomic variables to provide more FDI. In addition, it is suggested for the investors to consider the country's advantages that potentially provide rate of returns from the investment.

Keywords: Foreign direct investment; Shadow economy; Emerging economies; Investor motives; Efficiency-seeking motives; Economic growth; Policy rate.