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REVISITING QUALITY OF GOVERNANCE, FINANCIAL DEVELOPMENT, GLOBALISATIONS ON FOREIGN DIRECT INVESTMENT

Marhamah Mohd Rafidi (a), Jamaliah Said (b), Farha Binti Abdol Ghafar (c), Naila Erum (d)*,
Nurliyana Binti Haji Khalid (e)
*Corresponding author

(a) Taylors University, Malaysia, Marhamah.MohdRafidi@taylors.edu.my
(b) Accounting Research Institute, UiTM Shah Alam, Malaysia, jamaliah533@uitm.edu.my
(c) University Poly-Tech Malaysia, Kuala Lumpur, Malaysia, farha@uptm.edu.my
(d) Accounting Research Institute, UiTM Shah Alam, Malaysia, naila@uitm.edu.my
(e) Taylors University, Malaysia, nurliyana.khalid@taylors.edu.my

Abstract

Foreign direct investments (FDI) are an essential element of global economic development. The impact of Quality of governance (QoG), Financial Development (FD) and Globalisation Nexus have been debated as the core stimulation of FDI in emerging economies. This study is intended to revisit the influence of QoG and FD and Globalisation Nexus towards FDI among emerging economies. We provide empirical evidence based on income level; Upper and lower-income countries, while considering non-linear relationships. We analysed 35 years of panel time-series data of 40 developing countries starting from 1984 to 2019 by splitting sample size into upper and lower middle-income countries. We applied cross-sectional autoregressive distributed lags (CS-ARDL) for empirical analysis. The findings suggest that the QoG, FD and globalization nexus alone in the model are prominently stimulating FDI in both samples. In addition, we manifested the role of FD to QoG and globalization nexus as important in boosting FDI for both samples. This study attributes to the substantial contributions of government investment policy in the future.

Keywords: CS-ARDL, Foreign Direct Investment, Financial Development, Globalization, ICRG, Quality Of Governance

1. Introduction

The prominence of FDI Inflows to an economy and social sustainability (Adams, 2009; Akhter Shareef et al., 2009; Rahman, 2009; World Bank Group, 2018) motivated the researcher to investigate determinants of FDI Inflows. Foreign Direct Investment FDI is resilient mechanism to deal with the global economic and financial crisis, impeded of local investment (Adams, 2009; Kobrin, 2005) while domestic investment is insufficient of to deal with the volatile global economic environment, speculation or perception of investors and the possibility of financial and economic crises (Busse & Hefeker, 2007).

In contrast, Global FDI Inflows dropped by USD 1.43 trillion in 2015, USD 1.75 Trillion in 2016 and another drop of USD 1.3 Trillion in 2018. At the same time, the United Nations Conference on Trade and Development (UNCTAD) reported that developing countries faced an FDI Inflows crisis. UNTACSD reported a reduction of 14% of FDI Inflows (USD 720 billion) among developing countries. United Nations Conference on Trade and Development (2017) also reported that FDI Inflows in developing countries remained fragile; after a drop of USD 671 billion in 2016, FDI showed no sign of recovery. Concurrently, UNCTAD predicted and warned that global FDI Inflows would continue to decrease by up to 40% in 2020 (United Nations Conference on Trade and Development, 2017).

Developing countries offer abundant natural resources, labour, knowledge and others to explore and exploit. In comparison, developed countries are more able to explore and exploit the resources of developing countries (Akhter Shareef et al., 2009; Rahman, 2009; World Bank Group, 2018). In the Neo-Classical Theory, the impact of FDI is confined to Multinational Corporations (MNCs). However, living in an era where the quality of governance assists or distorts FDI Inflows growth, globalisation makes the world interconnected and, as a result, it breaks the barriers in certain countries, which enforces rapid capital movement between countries.

We admitted that extensive studies have been conducted to examine factors influencing FDI Inflows among developed and developing countries. However, economists and researchers claim that FDI is still the most ambiguous and dubious area (Akyuz, 2015). Leitao (2012) stated the ambiguity of FDI Inflows is due to different cultures, policies, currencies, geopolitics and risks. In the meantime, Eclectic theory and Institutional theory promptly promotes Quality of Governance, Financial Development, Globalisation Nexus (political, economic and social globalization) as core determinants to revisit.

Depending on globalisation alone without incorporating other major determinants makes the Eclectic Theory ineffective to encourage FDI Inflows. The Eclectic Theory integrates globalisation into Institutional FDI Fitness Theory. The Institutional FDI Fitness Theory suggests that FDI Inflows is affected due to the elasticity of a government's role, financial openness or development, the low degree of intervention of trade, low corruption and the ability of a country to swift from danger to opportunities and creativity (Wilhelms & Witter, 1998). Investors tend to countries with a high capacity to absorb the impact of globalisation rather than countries with poor readiness for globalisation, good quality governance, good infrastructure and low corruption as these create a competitive edge. Foreign investors avoid investing in countries with political uncertainty and conflicts.

Past studies have highlighted that income level is sensitive to country's growth, reshaping local and international business and invites FDI Inflows (Hammudeh et al., 2020; Sabir et al., 2019). The past study implies the distribution of empirical findings depends on the levels of income of the specific

country. Moreover, the World Bank provides classifications of countries according to their income level, for instance developing countries are classified according to income levels to upper Middle-Income countries and lower Middle-Income countries. This study is concerned with income sensitivity; therefore, we divided our sample countries into two types of income – Upper Middle- Income Countries and Lower Middle-Income Countries. This study intends to revisit whether Quality of governance, Financial Development and globalization nexus in promoting or prevailing the FDI. We argue that the model will significantly contribute to the literature when considering to split samples according to level of income. In addition, we concern the influence of non-linear relationships on our model of study, hence, we adopted the Cross Sectional Autoregressive Distributed Lags (CS-ARDL) approach.

The remainder of study is structured as follows. Section 2 presents literature review and hypothesis development. Section 3 covers the methodology part. Section 4 presents results and discussions. Section 5 concludes with policy implications and future direction of the study

2. Literature Review and Hypotheses Development

We review the relevant literature by dividing it into four strands and develop a hypothesis under each strand which we will examine to fulfil the objectives of this study:

2.1. Quality of Governance and FDI

According to Institutional FDI Fitness Theory, quality of governance is derived from the flexibility of institutions (country, government and corporations) in handling uncertainties and how the institution bounces back after an economic shock (Wilhelms & Witter, 1998). Strong governments are always preferred by Multinational Corporations (MNCs) and attract investors to locate their firms and mobilise their capital. Quality of governance is demonstrated through transparent and low corruption, disassociation from political activities in the military, strong implementation of policies, law and order, free from internal and external conflicts, free from religious and ethnic tensions, high democracy and stable socioeconomic conditions. Adopting Institutional FDI fitness theory in the framework of study should portray a country's performance and enhance FDI Inflows (Wilhelms & Witter, 1998). The contribution quality of governance towards FDI Inflows is undeniable (Ehsan, 2008; Rose-Ackerman & Tobin, 2005; Task Force on Higher Education and Society, 2000). Previous studies provide mixed empirical evidence. Past scholars have produced a few strands of opinions. The first group of scholars documented a positive relationship (Cieślik & Goczek, 2018; Morrissey & Udomkerdmongkol, 2012; Nizam & Hassan, 2018). High quality of governance by implementing a strong governance policy in a specific country builds foreign investor's confidence and attracts investments (Cieślik & Goczek, 2018; Morrissey & Udomkerdmongkol, 2012; Nizam & Hassan, 2018). The results are in line with the Institutional FDI Fitness Theory explanation. The theory suggests that high quality of governance establishes high capacity and flexibility in a specific country to manage economic shock and FDI Inflows sensitive and bumpy trend (Wilhelms & Witter, 1998).

While another group found no relationship between quality of governance and FDI Inflows (Goldsmith, 1987; Londregan & Poole, 1989; Mengistu & Adhikary, 2011), moreover, another group of scholars found the quality of governance established negative relationship to FDI Inflows (Egger &

Winner, 2005; Hakkala et al., 2008; Mauro, 1995). This mainly due to different measures of quality of governance, sample, timeline and the statistical technique. The conflicting empirical evidence warrants this study to reinvestigate the contribution of governance to FDI Inflows by considering ICRG element, which are government stability, investment profile, internal conflicts, external conflicts, politics in the military, ethnic tensions, religious tensions, bureaucracy stability, democracy accountability, law and order, corruption and socio-economic conditions, splitting developing countries into level income (Upper Middle-Income Countries and Lower Middle-Income Countries) and using an advance econometric technique which is Cross- sectional Autoregressive Distributed Lag (CS-ARDL).

Grosse and Trevino (2009) stated that a better Quality of governance mitigates uncertainty. Uncertainty leads to asymmetry of information and disrupts investor decision making. As a result, it distorts the attraction of investment locations. Dutta and Roy (2009) studies found transparency encouraging FDI Inflows. High transparency is a sign of high quality of governance. High transparency, especially in financial and stock market information, allows a foreign investor to make better decisions, in fact, that is a sign of the government avoiding the risk associated with corruption. Meanwhile, higher democracy and stability significantly influence FDI Inflows (Eichengreen & Leblang, 2008). Democracy is one main governance element (ICRG, 2018). Foreign investors are attracted to locate their money by owning cross-border firms in a highly democratic country.

Hopkin and Rodriguez-Pose (2007) and Egger and Winner (2005) found that corruption may act as grease in economic development and this includes the development of FDI Inflows as a tool of economic development (Adams, 2009; Dunning & Lundan, 2008; Kobrin, 2005; Moran, 2011; Navaretti & Venables, 2004). Unlike Hopkin and Rodriguez-Pose (2007) and Egger and Winner (2005), Cieślik and Goczek (2018) found that corruption leads to uncertainty, while uncertainty happens due to poor governance. Poor governance reduces the return on investment. Cieślik and Goczek (2018) precisely argued that corruption has a negative relationship with FDI Inflows. However, Selcuk and Yeldan (2001) stated there is no significant relationship between the risk of corruption and FDI Inflows.

The mixed body of literature above with the support of the Institutional FDI Fitness Theory warrants this study to revisit the hypothesis development. With regard to the Institutional FDI Fitness Theory (Wilhelms & Witter, 1998) and past scholars who are consistent with the Theory (Cieślik & Goczek, 2018; Gani, 2007; Grosse & Trevino, 2009; Khan et al., 2019; Mengistu & Adhikary, 2011; Morrissey & Udomkerdmongkol, 2012; Nizam & Hassan, 2018), which promotes quality of governance and encourages FDI Inflows. Therefore, this study proposes the following hypotheses:

H1a: Quality of governance has a significant and positive influence on FDI Inflows among Upper Middle-Income Countries

H1b: Quality of governance has a significant and positive influence on FDI Inflows among Lower Middle-Income Countries.

2.2. Financial Development and FDI

Financial development is the development and expansion of financial institutions such as banking institutions and the financial markets. Bahtiyar (2015) financial development refers to the size of the financial institution and the financial market, the efficiency, and stability of the financial system. While

the World Economic Forum (2012) defines financial development as an intermediate platform for multinational firms to access the market and financial institutions. Consistent with the Institutional FDI Fitness Theory (Wilhelms & Witter, 1998) and the Eclectic theory (Dunning & Lundan, 2008) suggests that a strong and stable financial system and financial institutions establish the competency of the FDI host country to offer a proper, efficient and strong accumulation of foreign capital and investment management, and as a result, leads to FDI Inflows growth.

According to prior studies, financial development is important for FDI Inflows (Bloch & Tang, 2003; Goldsmith, 1969; McKinnon, 1974; Shaw, 1973). For instance, Levine (2005) proved the importance of financial development to FDI Inflows globally. Levine (2005) also stated that high FDI Inflows is influenced by positive financial development. Alfaro et al. (2009), generalized that positive financial development growth promotes FDI Inflows among 62 developed and developing countries, while Ebrahimi Rad et al. (2016) produced the same evidence and argued that vigorous financial development reflects favourable FDI Inflows in Malaysia.

Desbordes and Wei (2017) and Bahri et al. (2018) found similar findings among sample 83 developed and developing countries, while Bahri et al. (2018) generalized that financial development promotes FDI Inflows for ASEAN (Malaysia, Indonesia, Thailand and Philippines) countries. The authors agreed that financial development is positive and significant to FDI Inflows. According to Bahri et al. (2018) an advanced financial system establishes financial development and increases foreign technology spillover and, at the same time, embraces FDI Inflows (Alfaro et al., 2004; Hermes & Lensink, 2003).

Hammudeh et al. (2020) provided comprehensive empirical evidence on the relationship between financial development and economic growth, which also represented FDI Inflows. After splitting the sample into different income levels, the result found that financial development profoundly increased economic growth among developing countries and upper and lower Middle-Income countries.

However, another strand of opinion contradicts Levine (2005), for instance, (Alfaro et al., 2009; Bahri et al., 2018; Desbordes & Wei, 2017; Ebrahimi Rad et al., 2016; Nabila, 2019), and. The scholars argued that financial development discouraged FDI Inflows. Nabila (2019) stated that financial development would negatively impact FDI Inflows. This is because they found a non-linear relationship between financial development and FDI Inflows in the context of 5 ASEAN countries. Perhaps data on Financial Development is statistically volatile and oversensitive to FDI Inflows. Furthermore, contradicting results were also provided by past scholars such as (Arcand et al., 2015; Deidda & Fattouh, 2002; Demetriades & Rousseau, 2011; Kaminsky & Reinhart, 1999; Rousseau & Wachtel, 2011).

In contrast, there is empirical evidence that portrays the insignificance of financial development to FDI (Arcand et al., 2015; Deidda & Fattouh, 2002; Demetriades & Rousseau, 2011; Kaminsky & Reinhart, 1999; Rousseau & Wachtel, 2011). Past scholars focused on developed and developing countries in order to provide empirical evidence on the relationship between financial development and FDI Inflows. In respect of the Institutional FDI Fitness Theories which suppress financial development as a prominent factor inducing FDI Inflows and based on latest findings among developing countries such as (Alfaro et al., 2009; Bahri et al., 2018; Desbordes & Wei, 2017; Hammudeh et al., 2020) who found a positive relationship between financial development and FDI Inflows, this study proposes the following hypothesis:

H4b: Financial development has significant and positive influence on FDI Inflows within Upper Middle-Income Countries

H4b: Financial development significant and positive influence on FDI Inflows within Lower Middle-Income Countries

2.3. Political Globalization and FDI

Political globalisation can be defined as the evolution of the political system, embarking on inter-regional transactions and the emergence of global governance institutions (Crouch, 2012; Thompson, 2007). According to the Eclectic Theory (Dunning, 1997), internalization or globalisation allows for rapid capital mobilization from foreign investors. By integrating the Eclectic Theory and the Institutional FDI Fitness Theory, political globalisation (PGI) would allow the country to adopt and adapt barriers and opportunities and enforces a country to be creative and flexible in embracing FDI Inflows (Leitao, 2012; Wilhelms & Witter, 1998).

As mentioned in the literature review, studies on political globalisation and FDI Inflows are limited compared to the impact of political globalisation on economic growth. Since the Iram et al. (2020) clearly stated that FDI Inflows is the engine of growth, this study decided to refer more to growth as a motivation for improving the literature. This study also found several scholars discussing specifically matters related to political globalization and FDI Inflows. Moreover, past literature has shown contrasting opinions.

A group of scholars have stated that political globalisation encourages FDI Inflows. For example, Dreher (2006) found globalisation, particularly political globalisation, positively influences FDI Inflows among global countries. Kılıçarslan and Dumrul (2018) found that political globalisation was positive and significantly impacted economic growth, which indirectly influences FDI Inflows. Consistent with Dreher (2006) and Kılıçarslan and Dumrul (2018), a recent study by Hammudeh et al. (2020) documented that political globalisation positively influences growth and at the same time encourages FDI Inflows globally. Another group found that political globalisation has an insignificant relationship to FDI Inflows. Ying et al. (2014) argued that political globalisation has no contribution to the growth and FDI Inflows, specifically in ASEAN countries. Dogan and Arslan (2016) found a similar relationship where political Globalisation has no relationship with FDI Inflows in Turkey. Hassan et al. (2019) found that political globalisation had no contribution to economic development, including FDI Inflows in ASEAN countries.

However, a group of studies found a negative relationship between political globalisation and growth. For instance, Chang and Lee (2010) argued that the intervention of politics in globalisation might hinder economic growth in a communist country. In respect to the Eclectic Theory which proposed that adopting globalisation promotes FDI Inflows and due to the gaps in empirical evidence, two types of hypotheses representing the sensitivity level of income are proposed as follows:

H2a: Political globalisation has significant and positive influence on FDI Inflows within Upper Middle-Income Countries

H2b: Political globalisation has significant and positive influence on FDI Inflows within Lower Middle-Income Countries.

2.4. Social Globalization and FDI

Freund and Djankov (2000) and Mody and Negishi (2001), argues that globalisation promotes economic growth as well as the movement of capital across borders, which is the FDI Inflows. Globalisation, including social globalisation, induces FDI Inflows by providing labour and professional skills spillover (Dreher, 2006; Hammudeh et al., 2020; Samargandi et al., 2020). According to the International Trade Theory, social globalisation increases FDI Inflows (Haberler, 1961). Dunning (1997) stated that the exposure of globalisation in a specific country promotes FDI Inflows. Consistent with the statement, past scholars had initiated empirical studies to prove the Theory. However, the empirical results are conflicting. Past studies produce several strands of opinion. There is a group of studies that state that social globalisation encourages FDI Inflows. For instance, Chang and Lee (2010) proved a positive relationship between social globalisation in promoting FDI Inflows among Organization Economic Cooperation Development (OECSD) countries. This is consistent with Villaverde and Maza (2011), Ayhan Kose et al. (2011), Leitao (2012) and Hammudeh et al. (2020) who found a positive relationship between social globalisation and FDI Inflows among developed and developing countries, while Ayhan Kose et al. (2011) and Carlos (2012) unanimously agreed that social globalisation stimulates growth as well as FDI Inflows. Meanwhile, Hammudeh et al. (2020) profoundly proved that social globalisation encourages economic development, including economic growth and FDI Inflows in global countries, after splitting the sample into 2 different levels of income.

Another strand of opinion is more to a negative relationship. Dreher (2006) argued that social globalisation deteriorates growth, including FDI Inflows. According to Dreher, vast Globalisation, especially social, may create opportunities for uncertainty and perhaps the adoption of corruption in the social structure. The empirical evidence is similarly shared by Ying et al. (2014), Rao and Vadlamannati (2011), specifically the impact of social Globalisation towards growth. Rao and Vadlamannati (2011) and Ying et al. (2014) found that social globalisation negatively influences growth including FDI inflows. Precisely, Rao and Vadlamannati (2011) found that social globalisation negatively influences economic development, including FDI Inflows, in 21 lower income countries. The idea was replicated by Ying et al. (2014), and scholars found similar results as Rao and Vadlamannati (2011) where social globalisation negative influenced economic development, including FDI Inflows. Even though prior studies had included Globalisation in their research model and discussed it in economic forums, this study found limited literature on social globalisation (SGI) and FDI Inflows. In relation to the Eclectic Theory, which proposed that adopting social globalisation promotes FDI Inflows and due to conflicting opinions by prior researchers, two types of hypotheses representing the sensitivity level of income are proposed as follows:

H3a: Social globalisation has significant and positive influence on FDI Inflows within Upper Middle-Income countries

H3b: Social globalisation has significant and positive influence on FDI Inflows within Lower Middle-Income Countries

3. Methodology

The Institutional FDI Fitness Theory and the Eclectic Theory argue that Governance, financial development (Wilhelms & Witter, 1998) and globalisation (Dunning, 1979) are prominent factors for FDI Inflows. Hence, this study aimed to examine four important factors, namely quality of governance, political globalisation, social globalisation and financial development and its effects on FDI Inflows among Upper Middle-Income countries and Lower Middle-Income Countries. This study focuses on developing countries due to high dependency on external financial resources/FDI incorporated for country growth and sustainability (United Nations Conference on Trade and Development, 2017). While the World Investment Report and past scholars reported that FDI Inflows is extremely vital as capital inducing for developing countries (Adams, 2009; Dunning & Lundan, 2008; Kobrin, 2005; Moran, 2011; Navaretti & Venables, 2004).

3.1. Data Collection

We collected annual data from 40 developing countries for 36 years from 1984 until 2019 from the World Development Indicator (WDI) for financial development and control variables. Meanwhile, Data for political globalisation and social globalisation were collected from the KOF Globalisation Index. For Quality of governance, the data collected were collected from International Country Risk Guide (ICRG) and Gothenburg University. We focused 12 proxies of quality of governance, namely, Government Stability, Investment Profile, Corruption, Politics in the Military, Internal Conflicts, External Conflicts, Ethnic Tensions, Religious Tension, Democracy Accountability, Bureaucracy Stability, and Socioeconomic Conditions.

Based on World Bank classification of countries, we categorised developing countries into upper Lower Middle-Income countries and Lower-Middle-Income countries. The World Bank classified country groups by using the Gross National Income per capita (GNI). Countries that owned a GNI capita between $996 USD and $3,896 USD were classified as Lower Middle-Income Countries5 (Meanwhile, GNI per capita between $3,896 USD and $12,055 USD or more were classified as Upper Middle- Income Countries (World Bank Group, 2018).

3.2. Cross Sectional Dependence, Panel Unit Root and CS-ARDL

3.2.1. Cross Sectional Dependence

First, we applied Cross-sectional Dependence (CSD) test by Pesaran (2004) to view the spillover between variables. Pesaran (2004) interpret CSD as $Yit = X1it + X2it + X3it$, where i= 1,2,3 … N and t= 1,2,3 … T. However, CSD is a major issue in panel data, especially in the social sciences area (Pesaran et al., 2001; Sarafidis & Wansbeek, 2012) as many factors are interrelated and non-independent, for example, persons, groups and social characteristics (Stephan, 1934). CSD happens perhaps due to counts, selecting individuals non-randomly, unobserved common shocks, due to a single currency, the common agro-climatic environment, and policies adopted by the central authority (Basak & Das, 2018). A serious CSD problem distorts the estimation model (O'Connell, 1998). In addition, the s selection of the unit root

techniques is due to the presence of the CSD problem (Levin et al., 2002; Pesaran et al., 2001). For instance, Levine (2005) suggested the selection of the second generation of unit root if the data portrays a high CSD value. Addressing the CSD problem in a panel data framework is important to reduce bias. The CSD test by Pesaran (2004) is to detect contemporaneous correlation across time and countries where the test follows the equation as follows:

$$CD = \left(\frac{TN(N-1)}{2}\right)^{1/2} \hat{P}$$

Where $\hat{P} = \left(\frac{2}{N(N-1)}\right)\sum \quad N-1\ i-1\ \sum \quad N\ j = i+1 \hat{P}_{ij}$ and $\hat{P}_{ij}$ points pair-wise correlation coefficient of the cross-sectional residuals obtained from Augmented Dickey Fuller (ADF) regression. T and N indicates time and cross-section dimensions, respectively.

Second, we applied second unit root analysis (CIPS) developed by Pesaran (2004). The recent econometrics literature has developed second-generation unit root tests (CIPS) (Bai & Ng, 2004b; Choi, 2002; Im et al., 2003; Moon & Perron, 2004; Pesaran, 2007) to overcome the problem of CSD issue across the units.

Due to the nature of the data in this study Autoregressive Distributed Lag (CS-ARDL) was the preferred choice. The CS-ARDL works efficiently in the presence of common unobserved effects. Meaning that the CS- ARDL technique is suitable to cater to potential cross-section bias in both the long-run and short-run relationships and is also very efficient in the presence of unobserved common effects (Chudik et al., 2016). CS-ARDL developed to overcome the error correction coefficient by computing an error correction model, which effectively produces the best and dynamic effect of variables. The CS-ARDL is also consistent in the presence of endogenous and serial correlations. In this study, the dependent variable which is FDI Inflows and independent variables (i.e., quality of governance, financial development, political globalisation and social globalisation; and other control variables (i.e., CO2 emission, labour force, and inflation rate), tended to have the serious cross-sectional problem. The cross-sectional problem might occur due to the integration of political, economic, social, culture, currency, diplomatic relationship, globalisation, knowledge and technology spillover, cross-sectional trade, and others (Pesaran & Tosetti, 2011). Hence, the CS-ARDL equations for baseline regression are as follows:

$$\Delta LFDII_{it} = \mu_i + (LFDII_{it-1} - \beta_i X_{it-1} - \phi_{1i}\underline{LFDII}_{t-1} - \phi_{2i}\underline{X}_{t-1})$$

$$+ \sum_{j=1}^{p-1}$$

$$+ \varepsilon_{it} q - 1$$

$$\lambda_{ij}\Delta LFDII_{it-j} + \sum_{j=0}$$

$$\zeta_{ij}\Delta X_{it-j} + \eta_{1i}\Delta LFDII + \eta_{2i}\Delta\underline{X}$$

Where $\Delta LFDII_{it}$ is the transformation of net FDI Inflows to algorithm version. $\Delta LFDII_{it}$ is dependent variable whereas X_{it-1} represents all independent variables. In the long-run analysis, $LFDII_{t-1}$ represents the dependent variable, $\phi_{2i}X_{t-1}$ represent all independent variables during the long-run. The equation also considers the short- run variables, therefore, $\eta_{1i}\Delta LFDII_t$ depicted the dependent variable for short-run and $\eta_{2i}\Delta X_t$ portrays the independent variable during the short-run.

4. Result and Discussion

4.1. Descriptive Analysis

Table 1. Descriptive Analysis

Variable	Obs	Mean	Std. Dev	Min	Max
FDII	1,386	5.04	2.14	-7.12	2.91
QoG	1,386	57.27	14.27	0	83.66
PGI	1,386	65.56	17.68	22.28	96.84
SGI	1,386	34.59	14.74	3.036	77.93
FD	1,386	33.77	27.92	-.622	166.50
CO2	1,386	2.366	1.719	.178	13.37
INF	1,386	70.09	602.16	-29.17	13611.63
LBF	1,386	4.28	1.22	201429.8	7.85

Note: FDII equivalent to FDI Inflows and dependent variable. QoG is the quality of governance index, PGI is the political globalisation index, SGI is social globalisation index, FD is the financial development. QoG, PGI, SGI and FD are independent variables. CO2 is CO2 emission, INF is the inflation rate, and LBF is the labour force. CO2, INF and LBF are control variable

Table 1 describes descriptive statistics of the respective variables considered in our framework. The mean of *PGI* is high in sample variables. The mean of CO2 is lowest among all variables. This shows that these variables are almost homogeneous.

Table 2 shows the partial correlation matrix. Partial correlation measures the correlation between two or more variables by controlling the effect of one or more continuous variables. Table 2 presents the results of partial correlation, semi-partial correlation, partial correlation^2, semi-partial correlation^2, and level of significance (p-values) for all the variables included in this study. The partial correlation results indicated that most of the variables in the model are profound to contribute to the model of the study except for FD. All variables exhibited a weak correlation, and little if any correlation existed. Meaning the data was unique and not dependent on each other. Partial correlation indicated a lower dependence of two random variables when other factors were controlled. It can be proven by the figures depicted in Table 2. The correlation for all the variables depicted little if any correlation existed for almost all the variables except SGI.

Table 2. Partial Correlation

	Partial	Semi partial	Partial	Semi partial	Significance
Variable	Corr.	Corr.	Corr.^2	Corr.^2	Value
QoG	0.1758	0.1139	0.0309	0.0130	0.0000
PGI	0.1109	0.0711	0.0123	0.0051	0.0000
SGI	0.3863	0.2670	0.1492	0.0713	0.0000
FD	-0.0159	-0.0102	0.0003	0.0001	0.5546
CO2	-0.1716	-0.1110	0.0294	0.0123	0.0000
INF	-0.0650	-0.0415	0.0042	0.0017	0.0158
LBF	0.5927	0.4692	0.3513	0.2201	0.0000

Dependent variable is FDI Inflows

4.2. Cross-Sectional Dependence and Second Generation (CIPS) Unit Root

Table 3. Cross-Sectional Dependence test and Second Generation (CIPS) Unit Root test

Variable	CSD	Abs (corr)	CIPS (level)	CIPS (1ˢᵗ diff)	CIPS \(2ⁿᵈ Diff)	CIPS (Level & Trend)	CIPS (Trend & 1ˢᵗ diff)
FDII	119.66***	0.710	-6.239***	-21.923***	-29.196***	-3.137***	-19.471 ***
QoG	51.90***	0.491	-6.371***	-16.763***	-26.642 ***	-4.764 ***	-15.109***
FD	131.15***	0.853	-5.382***	-15.533 ***	-27.341***	-2.339***	-14.334***
SGI	108.65***	0.658	-5.728***	-16.606***	-26.325***	-1.963***	-15.196***
SGI	138.40***	0.822	-5.594***	-17.258***	-27.355***	6.500 ***	-15.189 ***
QoGFD	87.85***	0.690	-7.046 ***	-16.786 ***	-26.345***	-5.356 ***	-14.838***
PGIFD	119.21***	0.776	-5.316 ***	-15.768***	-27.159 ***	-2.084***	-14.706 ***
SGIFD	136.49***	0.865	-5.346 ***	-16.189***	-26.181***	-4.837***	-13.0787***
CO2	6.57***	0.448	-3.194***	-20.589 ***	-29.509***	-2.899***	-18.813***
INF	32.21***	0.258	-10.406***	-25.940***	-29.943***	-7.824***	-24.015***
LBF	150.87***	0.986	-13.908***	2.037	-23.377***	6.205	-7.518***

Note: *** significant at 1%, ** at 5% and * at 10%

FDII equivalent to FDI Inflows is a dependent variable. QoG is quality of governance index, PGI is political globalisation index, SGI is social globalisation index, FD is financial development. QoG, PGI, SGI and FD are independent variables. CO2 is CO2 emission, INF is the inflation rate, and LBF is labour force. CO2, INF and LBF are control variables. QoGFD is the interaction of QOG and FD, PGIFD is interaction of PGI and FD, and last SGIFD is the interaction of SGI and FD.

Table 3 provides information on cross-sectional dependence and second-generation unit root analysis. This study used the symbol *** as a legend to explain the level of significance of the variables where *** exhibited high significance at less than .0001, ** depicts significance at .05 and * significant at .10. A similar symbol will be used simultaneously in explaining the level of the p-value for other analyses. Table 3 manifested the existence of CSD, where it depicts the second generation of unit root analysis which is CIPS (z, t-bar) of the unit root as established by Im et al. (2003). CIPS was effective in accounting when T and I are> 25. In addition, it applicable when CSD occurred (Bai & Ng, 2004a; Moon & Perron, 2004; Hammudeh et al., 2020). The CIPS column shows that each series contained a unit root issue. This study also reports CIPS unit root at first different, second different and CIPS trend at a level and first difference as for additional information. Most importantly, the results are showing all variable is stationary. Hence, the CSD and Second generation of unit root analysis (CIPS) warrant this study to comply the Cross-Sectional Autoregressive Distributed Lags (CS-ARDL) due to the existence of the CSD issue. CS-ARDL is the effective approach which accountable to cater issue of CSD in the short run, long-run, and joint short-run, and long-run

4.3. Cross-sectional Autoregressive Distributed Lags (CS-ARDL)

Table 4. The effect of all independent variable towards FDI Inflows in both samples: Comprehensive Model (CM) approach

Variables	Upper Middle-Income Countries			Lower Middle-Income Countries		
	M_1	M_2	M_3	M_1	M_2	M_3
CSD in SR						
Error Correction	-0.502*** (0.0669)	**-0.459*** (0.0763)**	-0.557*** (0.0716)	-0.598*** (0.0747)	**-0.566*** (0.0830)**	-0.650*** (0.0901)
Δ QoG	47.83 (37.75)	**35.53 (52.11)**	13.74 (33.03)	8.687 (17.11)	**-1.003 (15.63)**	11.43 (16.16)
Δ FD	76.79** (34.51)	**51.34* (30.73)**	41.80 (30.13)	-4.231 (28.20)	**-4.977 (26.11)**	5.418 (26.73)
Δ PGI	-16.53 (36.15)	**-4.422 (20.35)**	12.07 (26.19)	-47.66* (27.63)	**-31.80 (22.77)**	-48.54* (28.71)
Δ SGI	57.30 (53.06)	**18.63 (38.58)**	8.255 (54.89)	42.04** (17.96)	**24.70 (19.72)**	36.38** (18.26)
Δ QoGFD	-11.48 (9.556)	**-8.201 (13.21)**	-2.575 (8.395)	-1.732 (4.485)	**0.559 (4.171)**	-2.830 (4.279)
Δ PGIFD	2.637 (8.451)	**-1.300 (5.181)**	-4.615 (6.444)	11.88 (7.321)	**7.549 (6.109)**	10.76 (7.465)
Δ SGIFD	-14.61 (13.17)	**-5.028 (9.430)**	-2.133 (13.46)	-11.03** (4.698)	**-6.630 (5.246)**	-10.09** (4.890)
Δ CO2	-0.637 (0.521)	**-0.0818 (0.445)**	-0.288 (0.364)	-0.269 (0.464)	**-0.0248 (0.482)**	0.118 (0.436)
Δ INF	0.00973 (0.00779)	**0.00419 (0.00542)**	0.00628 (0.00610)	-0.00986 (0.0125)	**-0.0148 (0.0147)**	-0.00211 (0.0151)
Δ LBF	-0.193 (3.305)	**-1.118 (2.547)**	-2.292 (2.847)	-5.585 (7.871)	**-8.740 (7.229)**	-8.836 (7.723)
CSD in LR						
QoGt-1	-4.604*** (1.050)	**-2.063* (0.529)**	-16.10*** (3.372)	1.424*** (0.496)	**1.682*** (0.501)**	0.558 (0.535)
FDt-1	4.825*** (0.745)	**4.798 (3.987)**	-1.447*** (0.406)	7.172*** (1.816)	**19.54*** (4.100)**	18.13*** (3.692)
PGIt-1	5.936*** (0.330)	**7.992* (4.158)**	0.934** (0.449)	-2.068* (1.219)	**9.963*** (3.797)**	21.01*** (5.596)
SGIt-1	3.565*** (0.250)	**-3.481 (2.569)**	5.624*** (1.808)	-1.875*** (0.718)	**-1.014 (0.505)**	-10.58*** (2.029)

QoGFDt-1	1.852*** (0.369)	**1.171*** (0.150)**	5.037*** (0.868)	0.184 (0.135)	**-0.0132 (0.133)**	0.443*** (0.152)
PGIFDt-1	-1.671*** (0.0895)	**-2.692** (1.110)**	-0.432*** (0.130)	-0.249** (0.108)	**-3.650*** (0.977)**	-6.297*** (1.412)
SGIFDt-1	-0.362*** (0.0206)	**1.076* (0.623)**	-1.671*** (0.454)	0.221 (0.138)	**0.229** (0.102)**	2.890*** (0.585)
CO2t-1	0.887*** (0.123)	**0.591*** (0.194)**	-0.203 (0.166)	-0.000128 (0.000111)	**-0.453*** (0.107)**	-0.562*** (0.119)
INFt-1	0.000319** (0.000146)	**-6.74e-05 (5.88e-05)**	-7.23e-05 (0.000101)	-0.566*** (0.114)	**8.28e-05 (0.000121)**	-9.95e-05 (7.97e-05)
LBFt-1	1.551*** (0.381)	**-1.449*** (0.374)**	-1.346*** (0.406)	1.638*** (0.285)	**-1.100** (0.452)**	-0.599 (0.476)
Constant	-18.06*** (2.392)	**-5.595*** (0.971)**	-12.86*** (1.809)	-13.33*** (1.664)		
Observation	606	**606**	606	732	**732**	732

Note: ***, **, * denotes significance at the 1 %, 5 %, and 10 % levels, respectively. We apply the cross-sectionally autoregressive distributive lag (CS-ARDL) methodology in Chudik et al. (2016) under the condition of short-run heterogeneity and long-run homogeneity by solving the problem of cross-sectional dependence in the short-run (SR) (M1), short-run and long run (Joint) (M2), and long-run (LR) (M3)

Generally, the objective was to determine factors that affected FDI Inflows in developing countries. Specifically, the study's main objective was to determine the relationship between quality of governance, political globalisation, social globalisation, and financial development towards FDI Inflows in two samples (Upper Middle-Income Countries; and Lower Middle-Income Countries). Besides, this study also attempted to assess the significant relationship of quality of governance, political globalisation and social globalisation on FDI Inflows by moderating financial development in both samples of developing countries. The process of selecting those variables was driven by a review of previous literature and supported by theories. The findings for Cross-sectional Autoregressive Distributed Lags (CS-ARDL) are reported in table 4.

Based on the Institutional FDI Fitness Theory, Government effectiveness (governance quality), market fitness (Financial Development) and socio-culture fitness were adapted (Wilhelms & Witter, 1998). The Institutional FDI Fitness Theory posits that FDI is influenced by these elements. Next, this study extended the Institutional FDI Fitness Theory by adding decomposed globalisation elements, which is political globalisation and social globalisation, which is also in line with the Eclectic Theory (Dunning, 1979).

This study rejects the neoclassical FDI theory due to its weakness in fulfilling the imperfection market hypothesis. This study also rejected the use of the Eclectic Theory individually without integrating with the Institutional FDI Fitness Theory due to the condition of considering all elements such as

ownership, location and internalization/globalisation (OLI paradigm). The eclectic theory was unable to list governance and financial development in the framework.

This study established novelty by investigating the influence of the interaction between financial development and quality of governance, political globalisation, and social globalisation. This study found that few studies used quality of governance as an interaction variable and found fewer studies using financial development instead of the financial market as a moderating variable in FDI areas.

Moreover, this study found that only a few studies used the Cross Sectional- Autoregressive Distributed Lag (CS-ARDL) technique, such as Hammudeh et al. (2020), Samargandi et al. (2020), Erum and Hussain (2019). None specifically used that technique in the FDI Inflows area. In addition, this study follows the classifications of countries based on per capita income from the World Bank, and classifies developing countries into two groups levels of income: Upper Middle-Income Countries and Lower Middle-Income countries.

As a result, this study found that the effect of quality of governance, political globalisation, social globalisation and financial development on FDI Inflows is depended on the sample countries. In addition, this study proved that almost all the moderating models were accepted in both levels of income. Hence, financial development can be considered as a moderating factor for encouraging FDI Inflows in both groups levels of income.

Furthermore, quality of governance negatively affected FDI Inflows, and political globalisation manifested a positive relationship with FDI Inflows in the Upper Middle-Income Countries while the quality of governance, financial development and political globalisation showed a positive relationship to FDI Inflows. Indeed, then results in both samples are influenced by the level of income in the country concerned. Further, this research found sensitive elements that may be included in the quality of governance index. Principal component analysis suggested considering all 12 components based on the KMO figure. This study ended the process of analysis by conducting the Cross-Sectional Autoregressive Distributed Lags (ARDL) analysis for confirming the relationship of all variables. The result was consistent with the main finding.

All in all, it can be concluded that the results may suggest to policymakers and governments to strengthen remaining policies or implement effective new policies, especially investment policies such as foreign exchange control (FEC), by considering elements of quality of governance. The results suggest that more attention is given to government stability, investment profile, internal conflicts, external conflicts, politics in the military, ethnic tensions, religious tensions, bureaucracy stability, democracy accountability, law and order, corruption, and socio-economic condition proxies. In addition, this study urges attention to political globalisation, social globalisation, and financial development. This study is useful as a red flag to institutions involved in foreign trade control. Besides, this study is prominent to other researchers interested in extending the framework of this study and catering to the limitations highlighted for betterment.

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