



ARAŞTIRMA MAKALESİ | RESEARCH ARTICLE

DETERMINANTS OF FOREIGN DIRECT INVESTMENT INFLOWS IN THE  
EUROPEAN UNION (EU)

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**Abstract**

This study investigates the institutional factors influencing foreign direct investment within the Eurozone of the European Union (EU) and explores their correlation with economic integration. Attracting foreign direct capital investments is closely related to countries' efforts to make their institutional structures more competitive. Because economic integrations can contribute to economic growth by allowing these investments to increase. For his reason, the study focused on the course of foreign direct capital investments in the Eurozone in the 2002-2022 period and the institutional determinants of these investments were analyzed using the panel data method. The empirical analysis revealed that variables such as foreign direct investment, government effectiveness, political stability, and accountability did not experience any significant shocks. In the short term, a direct causal relationship between foreign direct capital investments and corruption has been found. Nevertheless, in the long term, it has been established that variables such as control of corruption, government effectiveness, political stability, rule of law, accountability, and regulatory quality collectively exhibit a causal relationship with foreign direct capital investments. These findings emphasize the importance of institutional structure for increasing foreign direct capital investments. Enhancements in governmental efforts to combat corruption, enhance governance effectiveness, promote political stability, uphold the rule of law, enhance accountability, and improve regulatory quality can significantly contribute to fostering foreign direct investment. In conclusion, this study provides valuable insights into the determinants of foreign direct investment in the euro area and offers guidance for future policy actions.

**Keywords:** Foreign Direct Investment, Institutional Quality, Panel Data

## AVRUPA BİRLİĞİ'NE (AB) DOĞRUDAN YABANCI YATIRIM GİRİŞLERİNİN BELİRLEYİCİLERİ

### Öz

Bu çalışma, Avrupa Birliği'nin (AB) Euro bölgesindeki doğrudan yabancı sermaye yatırımlarının kurumsal belirleyicilerini incelemekte ve bu yatırımların ekonomik entegrasyonlarla nasıl ilişkilendirildiğini analiz etmektedir. Doğrudan yabancı sermaye yatırımlarının çekilmesi, ülkelerin kurumsal yapılarını daha rekabetçi hale getirme çabalarıyla yakından ilişkilidir. Çünkü ekonomik entegrasyonlar, bu yatırımların artmasına olanak tanıyarak ekonomik büyümeye katkıda bulunabilirler. Bu nedenle, çalışmada Euro bölgesindeki doğrudan yabancı sermaye yatırımlarının 2002-2022 dönemindeki seyrine odaklanılmış ve bu yatırımların kurumsal belirleyicileri panel veri yöntemiyle analiz edilmiştir. Yapılan ampirik analizler sonucunda, doğrudan yabancı sermaye yatırımlarının, hükümet etkinliği, siyasi istikrar ve hesap verebilirlik gibi değişkenlerin herhangi bir şoka maruz kalmadığı bulgusuna ulaşılmıştır. Kısa dönemde ise, doğrudan yabancı sermaye yatırımlarının yolsuzluklarla doğrudan bir nedensellik ilişkisi bulunmuştur. Ancak uzun dönemde, kontrol altındaki yolsuzluk, hükümet etkinliği, siyasi istikrar, hukukun üstünlüğü, hesap verebilirlik ve düzenleyici kalite gibi değişkenlerin topluca doğrudan yabancı sermaye yatırımlarına doğru bir nedensellik ilişkisi gösterdiği tespit edilmiştir. Bu bulgular, doğrudan yabancı sermaye yatırımlarının artırılması için kurumsal yapının önemini vurgulamaktadır. Hükümetlerin yolsuzlukla mücadele, etkin bir yönetim sağlama, siyasi istikrarı sağlama, hukukun üstünlüğünü koruma ve hesap verebilirlik ve düzenleyici kaliteyi artırma gibi alanlarda yapacakları iyileştirmeler, doğrudan yabancı sermaye yatırımlarını teşvik etmede önemli bir rol oynayabilir. Sonuç olarak, bu çalışma, Euro bölgesindeki doğrudan yabancı sermaye yatırımlarını etkileyen faktörleri anlamak ve gelecekteki politika önlemlerini belirlemek için önemli bir katkı sağlamaktadır.

**Anahtar Kelimeler:** Doğrudan Yabancı Yatırım, Kurumsal Kalite, Panel Veri

### INTRODUCTION

Foreign direct investments have increased significantly during the globalization process. The economic impacts of these investments vary in terms of entry channels and the segments they affect. However, in general, it is accepted in the literature that foreign direct capital positively affects the host country's economy. In particular, foreign direct investments facilitate the transfer of technology and knowledge, increase the competitiveness of local companies and contribute to international integration. Moreover, it is apparent that these investments contribute to the development of human capital within the host country. Given these aspects, foreign direct investments play a supportive role in driving economic growth in host countries. This dynamic intensifies competition among nations vying to attract foreign direct investments. Foreign direct investments are one of the significant factors affecting the world economy as an important part of international financial integration. With globalization, countries in need of capital are developing policies and strategies to improve their investment environments in order to attract foreign direct investments (Artan, Hayaloğlu 2015:551:552).

As stated by Daniele and Marani (2006), the impact of institutions on foreign direct investments occurs through three different channels. First, effective institutional structures encourage foreign investment by increasing the efficiency of enterprises. This is because businesses that operate under sound institutions operate in a safer environment, thus making investing more attractive. Second, strong institutions increase foreign investment by reducing

transaction costs. Better corporate structures provide the infrastructure necessary to resolve disputes between businesses and make legal processes more efficient. Finally, good institutions encourage foreign investment by providing a reliable environment for multinational companies through their presence. Because high-cost foreign direct investments are often full of uncertainties and risks, and good institutions can reduce these risks.

Research conducted by Benassy-Quere et al. (2007) suggests that institutions can serve as a mechanism that promotes productivity enhancement in the context of the relationship between institutional structure and foreign direct investments. Good institutions can increase the willingness to invest by providing a more predictable environment for investors. This could be a significant factor for economic development, particularly considering that foreign direct investment plays a crucial role in capital formation within developing countries. Good institutions can support growth and development by attracting and reassuring foreign investors.

Globerman and Shapiro's (2002) research investigates the correlation between indicators of national institutional systems and Foreign Direct Investment (FDI) across 144 countries. Among other findings, the study elucidates how FDIs are influenced by corporate standards. In this context, the authors demonstrate that "political governance is crucial, and improving it does not necessarily entail governments making significant investments of taxpayers' money(...). In fact, enhancing governance may often align more with governments assuming a lesser economic and regulatory role. Political governance fosters an increase in inward FDI, particularly benefiting smaller developing countries (Globermann and Shapiro 2002:42).

In this field of research, economists examine the connections between institutions and Foreign Direct Investment (FDI). These studies uncover various pathways through which institutions can impact FDI flows. Firstly, strong institutions are identified as stimulating investment by augmenting factor productivity. Secondly, sound institutions mitigate investment-related transaction costs, such as those associated with corruption; Due to the substantial capital investment involved in foreign direct investment (FDI), factors such as the enforcement of property rights and the efficacy of the legal system can impact the insecurity arising from social and political instability.

In this context, the protection of the legal framework and property rights is of great importance for the successful realization of the investment.

## **1. LITERATURE REVIEW**

In their 2015 study, Artan and Hayaloğlu examined the economic and institutional determinants influencing foreign direct investment across 29 OECD countries. The research provided insights into the political risk and institutional quality of nations, employing twelve sub-components such as government stability, investment profile, corruption, law and order, and bureaucratic quality. The results indicate that institutional indicators, rather than economic ones, are the primary determinants of foreign direct investment in OECD countries.

These institutional indicators include government stability, socioeconomic status, investment profile, civil unrest, military involvement in politics, religious tensions, law and order, ethnic

tensions, and bureaucratic quality. The findings underscore the crucial role of a sound institutional framework in attracting foreign direct investment to OECD countries.

As stated in the literature, a quality institutional structure supports the view that it will reduce transaction costs by reducing uncertainties and thus provide a suitable environment for investments. These findings serve as a vital guide for policymakers, underscoring the imperative of improving institutional quality to attract foreign direct investment and leverage the positive effects of such investments.

The globalization process has caused a significant increase in foreign direct capital inflows worldwide since the 1980s. This surge has prompted numerous studies investigating both the macroeconomic and microeconomic effects and determinants of foreign direct capital investments.

The study by Bayar and Öztürk (2016) reviewed the literature on the determinants of foreign direct capital investments. Several empirical studies in this field have shown that factors including market size, economic growth, inflation, trade and financial openness, human capital, institutional quality, infrastructure, political stability, taxation, and population size play crucial roles as determinants of foreign direct capital inflows.

Klaew and colleagues (2016) utilized regression analysis to examine the impact of institutional quality on foreign direct investment in Thailand from 2013 to 2015. The research results suggest that poor governance and complex legal regulations negatively affect the inflow of foreign direct investment. This underscores the significance of institutional quality as a crucial determinant of foreign capital investments in Thailand.

Li et al. (2018) conducted a regression analysis to explore the influence of institutional disparities on foreign direct capital investments in China from 2003 to 2015. Their study concluded that institutional differences indeed exert a statistically significant impact on foreign direct investment. This discovery highlights the pivotal role of institutional structures in China regarding foreign capital investments.

Bouchoucha and Benammou (2020) investigated the influence of institutional quality on foreign direct investment in 41 African countries from 1996 to 2013, utilizing the panel data analysis methodology. The study revealed a positive correlation between institutional quality and foreign direct investment. This finding emphasizes that institutional structures in African countries are an important factor in terms of foreign direct capital investments

In Yakubu's study (2020), the impact of institutional quality on foreign direct capital investments in Ghana during the period 1985-2016 was investigated using the ARDL bounds test.

The findings indicate a favorable impact of institutional quality on foreign direct investment. This finding reveals that institutional structures in Ghana play a critical role in terms of foreign capital investments.

The research carried out by Hacıımamoğlu (2016) investigated the institutional factors influencing foreign direct investments in OECD countries from 1989 to 2014. The study utilized

the share of foreign direct investments in Gross Domestic Product as the dependent variable and analyzed a total of 14 variables, including 5 macroeconomic and 8 institutional factors. The analyses revealed that variables such as openness to foreign trade, labor costs, protection of property rights, and enforceability of contracts exerted statistically significant influences on foreign direct investments. However, variables including market size, inflation, exchange rates, bureaucratic efficiency, political stability, corruption levels, democracy index, regulatory framework, and tax policies were not observed to have a significant influence on foreign direct investments.

Özcan and Ayşe (2010) state that direct foreign investments (FDI) made by multinational companies generally take the form of establishing a new facility or purchasing an existing company. The spread of such investments dates back to the late 1950s, and they state that international investments gained momentum with the liberalization of capital. Liberalized national economies understood the importance of foreign investments for economic growth and development and began to attract foreign investors with various strategies and policies. This situation has led to the creation of a competitive environment between countries to attract foreign investors. In the theoretical part of the study, the importance, determinants and types of foreign direct investments are explained.

The empirical analysis involved investigating the factors influencing Foreign Direct Investment (FDI) in 27 OECD countries from 1994 to 2006, employing the dynamic panel data analysis method and the Generalized Method of Moments (GMM) estimation technique. According to the findings of the study, it was noted that the growth rate, level of infrastructure, and inflation positively influenced FDI. Additionally, openness and current account balance variables were found to be negatively related to FDI, contrary to expectations.

The study conducted by Demirtaş (2005) aims to investigate the influence of institutional factors on foreign direct investments (FDI) in 71 developed and developing countries from 1995 to 2002. In the first part of the study, foreign direct investment theories and regional distribution are discussed, and in the second part, economic and institutional factors affecting foreign direct investments are discussed. In the third part, three different models were developed and tested.

The results of the study suggest that institutional factors, encompassing elements such as voice, accountability, political stability, bureaucratic effectiveness, rule of law, regulatory quality, and anti-corruption measures, demonstrate a positive association with Foreign Direct Investment (FDI). Additionally, it was emphasized that the effect of market size on FDI is limited and that regional market size has become more important today. As for economic factors, it has been revealed that the impact of labor costs and quality of infrastructure decreases, and the level of openness to foreign exchange is a determinant on FDI. The research also concluded that differences arising from the region in which countries are located affect FDI flows and that countries with high institutional quality are more successful in attracting FDI. It has been emphasized that in countries with high institutional quality, investment costs are reduced and future uncertainties are eliminated.

## 2. EMPIRICAL RESULTS

This study investigates the institutional drivers influencing foreign direct capital investments in the EU 27 region throughout the period spanning from 2002 to 2022. Information about the variables taken from the World Bank database is included in Table 1.

**Table 1. Tests for cross-sectional dependency**

<i>Constant</i>	Statistic	p-value
$CD_{lm}$ (BP,1980)	664.143	0.00***
$CD_{lm}$ (Pesaran, 2004)	11.819	0.00***
$CD$ (Pesaran, 2004)	8.345	0.00***
$LM_{adj}$ (PUY, 2008)	-2.894	0.99

Notes:  $\Delta y_{i,t} = d_i + \delta_i y_{i,t-1} + \sum_{j=1}^{p_i} \lambda_{i,j} \Delta y_{i,t-j} + u_{i,t}$  In the model, the number of lags (pi) is taken as 1.

Probabilities are in parentheses. a, b, and c denote statistical significance at the 1%, 5%, and 10% level of significance, respectively.<sup>1</sup>

**Table 2. Panel Unit Root Tests utilizing the "bootstrap" method by Smith et al. (2004)**

<i>Levels</i>	<u>Constant</u>		<u>Constant and Trend</u>	
	Statistic	Bootstrap p-value	Statistic	Bootstrap p-value
<u><i>FDI</i></u>	-3.368	0.00 <sup>a</sup>	-3.585	0.00 <sup>a</sup>
<u><i>CoC</i></u>	-1.508	0.57	-2.138	0.57
<u><i>GE</i></u>	-1.923	0.09 <sup>c</sup>	-2.404	0.19
<u><i>PS</i></u>	-2.733	0.00 <sup>a</sup>	-3.078	0.00 <sup>a</sup>
<u><i>RQ</i></u>	-1.730	0.24	-2.371	0.26
<u><i>RoL</i></u>	-1.724	0.29	-2.338	0.22
<u><i>VaA</i></u>	-2.14	0.05 <sup>c</sup>	-2.749	0.02 <sup>b</sup>
<b><u>First difference</u></b>				
<u><i>FDI</i></u>	-6.139	0.00 <sup>a</sup>	-6.045	0.00 <sup>a</sup>
<u><i>CoC</i></u>	-4.644	0.00 <sup>a</sup>	-4.698	0.00 <sup>a</sup>
<u><i>GE</i></u>	-4.656	0.00 <sup>a</sup>	-4.712	0.00 <sup>a</sup>
<u><i>PS</i></u>	-5.182	0.00 <sup>a</sup>	-5.130	0.00 <sup>a</sup>
<u><i>RQ</i></u>	-6.318	0.00 <sup>a</sup>	-6.492	0.00 <sup>a</sup>
<u><i>RoL</i></u>	-4.965	0.00 <sup>a</sup>	-5.048	0.00 <sup>a</sup>
<u><i>VaA</i></u>	-5.289	0.00 <sup>a</sup>	-5.300	0.00 <sup>a</sup>
<b><u>Homogeneity</u></b>				
$\tilde{\Delta}$	0.924	0.178		
$\tilde{\Delta}_{adj}$	0.999	0.159		

<sup>1</sup> Following Sayed and Peng (2021), only the horizontal cross-section dependence results of the dependent variable are included.

The maximum delay length was taken as 4 and the optimal delay lengths were determined with the general-to-specific approach. Probability values were obtained from 5000 bootstrap distributions. a, b and c denote statistical significance at the 1%, 5%, and 10% level of significance, respectively.

**Figure 1. Variable Definitions**

Variables	Symbol
Foreign direct investment, net inflows (% of GDP)	FDI
Control of Corruption	CoC
Government Effectiveness	GE
Political Stability	PS
Rule of Law	RoL
Voice and Accountability	VaA
Regulatory Quality	RQ

According to the CD and CDIm test results presented in Table 2, there appears to be horizontal cross-section dependence in FDI. Table 3 displays the results of the "bootstrap" panel unit root test conducted by Smith et al. (2004), indicating that the FDI variable does not exhibit a unit root at the level value. The GE variable is stationary at 10% significance level in the model with constant. The PS variable exhibits stationarity at the 1% significance level in both the fixed and trended models. The VaA variable is stationary at the 10% level of significance in the fixed model and at the 5% level of significance in the trended model. On the other hand, all variables are stationary at the 1% significance level in the first difference. In delta tests, the null hypothesis is that the slope coefficients of the countries in the panel are homogeneous and therefore the slope coefficients are equal to each other, while the alternative hypothesis is that the coefficients are different from each other, i.e. heterogeneous. Cointegration methods based on heterogeneous estimation are used according to probability values. Accordingly, the slope coefficients for each country in the panel are different from each other.

**Table 3. LM Bootstrap Panel Cointegration**

Tests	Constant			Constant and Trend		
	Statistic	Asymptotic p-value	Bootstrap p-value	Statistic	Asymptotic p-value	Bootstrap p-value
$LM_N^+$	-0.480	0.81	0.73	2.672	0.29	0.02**

Note: Bootstrap probability values were derived from 1,000 replicate distributions, while asymptotic probability values were obtained from the standard normal distribution. Significance levels are denoted by \*\*\*, \*\*, and \*, indicating statistical significance at the 1%, 5%, and 10% levels, respectively.

The difference of the LM bootstrap test from other cointegration tests is that the test statistics are obtained by both asymptotic and bootstrap method. In the LM bootstrap cointegration test, the null hypothesis is that there is cointegration between the variables and the alternative hypothesis is that there is no cointegration. In the model, the null hypothesis clearly claims that

there is a long-run relationship in the model with constants. In the model with trend, asymptotically there is cointegration but bootstrap shows that there is no cointegration.

**Table 4. Panel VAR and Panel VECM Causality**

	Short-run causality							Long-run causality
	$\Delta$ (lnFDI)	$\Delta$ (GE)	$\Delta$ (CoC)	$\Delta$ (PS)	$\Delta$ (RQ)	$\Delta$ (RoL)	$\Delta$ (VaA)	ECT(-1)
$\Delta$ (FDI)	-	0.715 (0.86)	11.725 (0.00) <sup>a</sup>	0.694 (0.87)	0.964 (0.80)	1.388 (0.71)	0.406 (0.93)	-1.008 [-16.646] <sup>a</sup>
$\Delta$ (GE)	1.018 (0.79)	-	2.050 (0.56)	3.197 (0.36)	0.534 (0.91)	2.587 (0.45)	0.306 (0.95)	2.63E-06 [0.013]
$\Delta$ (CoC)	8.780 (0.03) <sup>b</sup>	0.127 (0.98)	-	5.479 (0.36)	3.620 (0.30)	13.260 (0.00) <sup>a</sup>	3.449 (0.95)	-0.0006 [-1.147]
$\Delta$ (PS)	0.381 (0.94)	9.904 (0.01) <sup>b</sup>	4.432 (0.21)	-	4.766 (0.18)	12.071 (0.00) <sup>a</sup>	15.716 (0.00) <sup>a</sup>	-0.0001 [-0.514]
$\Delta$ (RQ)	0.756 (0.86)	1.766 (0.62)	8.384 (0.03) <sup>b</sup>	2.228 (0.52)	-	0.276 (0.96)	8.386 (0.03) <sup>b</sup>	-0.0029 [-1.095]
$\Delta$ (RoL)	0.664 (0.88)	3.817 (0.28)	1.855 (0.60)	12.818 (0.00) <sup>a</sup>	3.268 (0.35)	-	0.760 (0.85)	-0.00019 [-1.374]
$\Delta$ (VaA)	4.324 (0.22)	2.707 (0.43)	6.649 (0.08) <sup>c</sup>	3.246 (0.35)	9.056 (0.02) <sup>b</sup>	8.861 (0.03) <sup>b</sup>	-	-7.30E-05 [-0.734]

Notes: The symbols \*\*\*, \*\*, and \* represent significance levels of 1%, 5%, and 10%, respectively, while () and [] indicate probability values and t statistics, respectively.

In the short term, there is observed causality at the 5% significance level from the CoC variable to FDI. However, in the long run, there is significant causality from the collective independent variables to FDI, evidenced at the 1% significance level. In the model where FDI is included as the dependent variable, short-term imbalances are rebalanced in approximately 1 year. Alternative causality results are also obtained from Table 5. In the short term, from PS to GE at 5% significance level, from FDI, RQ and VaA to CoC, from VaA to RQ at 5% significance level, from RQ, CoC and PS to RoL, There is causality from PS and RQ to VaA. Azam et al. (2010) contend that in the long run, there is no discernible causal relationship among the determinants of FDI. They attribute the absence of causality in the short term to the uncertainty stemming from monetary and fiscal policies, which serves as a barrier to foreign capital inflows. Since EU member countries are in the upper-middle income group, there is a strong correlation between institutional factors and foreign direct investments (Khan and Akbar, 2013). The issue can be viewed from the perspective of the internalization theory developed by Dunning (1994). Accordingly, externalities created by the Eurozone as well as political risks in other developed countries direct foreign capital investments to the EU. Thus, international companies may turn to countries where the institutional structure is developed due to market failures in other countries.

## CONCLUSION

With classical economics, theoretical discussions have begun regarding the institutional structure being the most important determinant of economic growth. Smith states that the most important determinant of steady-state equilibrium is the institutional structure and that an economy in which the institutional structure constantly changes cannot reach steady-state equilibrium. This study attempts to reveal which institutional factors affect direct foreign capital investments in EU countries. In the short run, there is only causality from corruption to foreign direct investment. In the long run, there is causality from all institutional factors used in the



empirical analysis to foreign direct capital investments. Thus, it can be seen that Keynesian economics is one step ahead in short- and long-term equilibrium discussions. In this study, similar to the studies of Busse and Hefeker (2007) and Antonakakis and Tondl (2011), property rights, freedom and accountability, political stability, regulatory quality, rule of law, corruption are institutional factors that create an encouraging economic structure for foreign direct capital investments. The result presented is obtained. According to the results obtained from this study, the most important factor to pay attention to within the institutional structure is corruption. With a result similar to the empirical literature examining the institutional determinants of foreign direct capital investments, this study concludes that institutional structure will reduce transaction costs by reducing policy uncertainties. Thus, it is thought that the sensitivity of capital movements will increase and there will be a multiplier movement in increasing foreign direct capital investments. It is recommended that future studies model foreign direct capital investments with panel gravity or geographically weighted regression. Thanks to these models, it will be possible to reveal whether geographical locations have an impact on foreign direct investments, the effects of intra-industry trade, and how effective institutional factors are in the selection of production locations.

### **EXTENDED ABSTRACT**

The research explores the institutional factors influencing foreign direct investment (FDI) inflows within the Eurozone of the European Union (EU) and examines the relationship between these investments and economic integration. FDI attraction closely intertwines with countries' endeavors to bolster their institutional frameworks for heightened competitiveness. Economic integrations, in turn, can foster economic growth by facilitating an upsurge in such investments. Thus, the research undertakes a thorough examination of the trajectory of FDI in the Eurozone spanning from 2002 to 2022, employing panel data methodology to dissect its institutional determinants. The empirical scrutiny reveals that FDI exhibits resilience against shocks in variables such as government effectiveness, political stability, and accountability in the short term. However, while a direct causal connection between FDI and corruption appears evident in the short term, the long-term scenario reveals a collective causal relationship with FDI involving controlled corruption, strengthened government effectiveness, political stability, adherence to the rule of law, accountability, and enhanced regulatory quality. These findings underscore the pivotal role of institutional structure in augmenting FDI. Notably, governmental enhancements in combating corruption, ensuring effective governance, upholding political stability, reinforcing the rule of law, enhancing accountability, and improving regulatory quality can substantially bolster FDI. In essence, this study substantially contributes to unraveling the factors that influence FDI within the Eurozone and delineating prospective policy interventions.

Foreign direct investment (FDI) has surged notably amidst the globalization tide, engendering diverse economic ramifications contingent upon entry channels and affected sectors.

However, existing literature universally recognizes the beneficial impact of FDI on host economies. FDI facilitates the transfer of technology and knowledge, amplifies the competitiveness of local enterprises, and fosters international integration. Moreover, it catalyzes the development of human capital within host nations, thereby buttressing economic growth. This narrative accentuates the intensifying competition among nations

to court FDI, considering it as a vital cog in the machinery of international financial integration. As underscored by Daniele and Marani (2006), the influence of institutions on FDI operates through three distinct channels. Firstly, robust institutional frameworks spur FDI by engendering heightened firm productivity, stemming from the enhanced security accorded to firms. Secondly, sound institutions curtail transaction costs, thereby greasing the wheels for increased FDI. Lastly, commendable institutions furnish multinational corporations with a secure haven for their assets, thereby nurturing FDI. Costly FDI ventures are often fraught with uncertainties and risks, which can be mitigated by sound institutional frameworks.

Insights from studies by Benassy-Quere et al. (2007) underscore institutions as facilitators of productivity gains and FDI attraction. Sound institutions breed investor confidence by furnishing a more predictable investment climate, a critical factor for economic development, particularly in the context of FDI's pivotal role in capital formation within developing economies. Similarly, the study by Globerman and Shapiro (2002) elucidates the nexus between national institutional frameworks and FDI across 144 countries. Notably, the authors highlight how improved governance can redound to diminished governmental investments at the taxpayers' expense, thereby ushering in a diminished economic and regulatory role for governments, particularly in smaller developing nations. This research terrain elucidates the multifaceted relationships between institutions and FDI, elucidating how institutions can impact FDI flows through various avenues. Good institutions not only catalyze investment by bolstering factor productivity but also truncate investment-related transaction costs, while social and political instability breed insecurity, which in turn affects confidence levels, property rights implementation, and legal system efficiency, particularly vis-à-vis capital-intensive greenfield FDI ventures.

Theoretical discourses have commenced orbiting the institutional structure as the preeminent determinant of economic growth, aligning with classical economic tenets. Smith posits the institutional structure as the sine qua non for equilibrium in a stationary state, contending that a constantly evolving institutional framework precludes the attainment of such equilibrium. This study endeavors to unearth the institutional factors impinging on FDI within EU nations. In the short term, only corruption emerges as causally linked to FDI, while in the long term, all institutional factors scrutinized in the empirical analysis exhibit causality with FDI. Consequently, Keynesian economics emerges as a frontrunner in discussions pertaining to short-long term equilibrium. Consistent with the conclusions drawn by Busse and Hefeker (2007) as well as Antonakakis and Tondl (2011), this study affirms that factors such as property rights, freedom, accountability, political stability, regulatory quality, adherence to the rule of law, and corruption within the institutional framework collectively foster a conducive environment for FDI. Emphatically, corruption emerges as the linchpin within the institutional scaffold. It is deduced, akin to empirical literature probing institutional determinants of FDI, that a robust institutional edifice can whittle down transaction costs by assuaging policy uncertainties, thereby likely fomenting a multiplier effect in augmenting FDI. Future inquiries are encouraged to model FDI using panel gravity or geographically weighted regression to unravel the geographical dimensions impacting FDI, ascertain the ramifications of intra-industry trade, and gauge the efficacy of institutional factors in shaping production location preferences.

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