FOREIGN DIRECT INVESTMENT: DOES ACCESS TO CIVIL JUSTICE MATTER?

A Thesis
submitted to the Faculty of the
Graduate School of Arts and Sciences
of Georgetown University
in partial fulfillment of the requirements for the
degree of
Master of Public Policy
in Public Policy

By

Cristina Botero, LL.B

Washington, DC
April 15, 2011
FOREIGN DIRECT INVESTMENT: DOES ACCESS TO CIVIL JUSTICE MATTER?

Cristina Botero, LL.B
Thesis Advisor: Julio Guzman, PHD.

ABSTRACT

Development literature suggests that legal systems provide the framework for examining the main drivers of development. As one of the main legal tools through which lay citizens and companies can enforce contracts, the present analysis focuses on assessing the impact that the level of access to the legal system has on foreign investors’ decisions. Using a two stage least square (2 SLS) regression and data from the Rule of Law Index collected in 2009, this paper finds that the access to civil justice does not have a significant effect on Foreign Direct Investment. Further, the regression analysis indicates that the amount of taxes paid by the businesses as a percentage of commercial profits, the number of days to start a business and the Gross Domestic Product Per Capita are more important to attract foreign capital than the finding itself.
Dedication

To my parents who always give me unconditional love and support to accomplish everything I set out to do.
# Table of Contents

Dedication .................................................................................................................. iv

Table of Contents ...................................................................................................... v

List of Tables ............................................................................................................. vi

List of Figures ........................................................................................................... vi

Introduction ............................................................................................................. 1

Chapter I: Access to Civil Justice and Development.................................................. 3

Chapter II: Literature Review: Is there an empirical link between Access to Civil Justice and Foreign Direct Investment? ................................................................. 5

Chapter III: Descriptive analysis ............................................................................ 10

Chapter IV: Quantitative Strategy .......................................................................... 13

Section 1: Quantitative approach ............................................................................ 13

Section 2: Data report and descriptive statistics ...................................................... 16

Section 3: What to expect from the Cross-Country regression analysis? ............... 26

Chapter V: Results .................................................................................................. 27

Chapter VI: Conclusion and Policy Implications ..................................................... 33

Appendix .................................................................................................................. 35

Bibliography ............................................................................................................ 38
LIST OF TABLES

Table Nº 1: Variables of interest summary
Table Nº 2: Sample’s distribution

LIST OF FIGURES

Figure Nº 1: Access to Civil Justice vs Foreign Direct Investment: 35 countries, 2009
Figure Nº 2: Time to Enforce Contracts vs Foreign Direct Investment: 35 countries, 2009
Figure Nº 3: Good Governance Contracts Enforcement Indicator vs Foreign Direct Investment: 32 countries, 2009
Figure Nº 4: Procedures to Enforce Contracts vs Foreign Direct Investment: 35 countries, 2009
Figure Nº 5: Distance to Ecuador vs GDP: 2009
Figure Nº 6: Sample’s distribution map
INTRODUCTION

Foreign direct investment (FDI) is one of the principal components of capital flows and technological progress in developing countries. As a result, more and more developing countries are lowering barriers to foreign capital. From the business perspective, the continuing global trend to search better businesses environments, better technology, and more competitive prices increases corporations’ interest on crossing national borders to place investments abroad (TEIU 2011).

When looking for an investment destination, a country’s investment climate is the corporation’s main criterion. The liberalization/protectionism of economies, the policies towards foreign investors and general macroeconomic conditions are the basic elements they consider. Other characteristics that have been cited by investors as affecting their decisions are the political risks and governance issues. For instance, a survey of investors worldwide conducted by the Economist Intelligence Unit in 2007 revealed that in emerging markets the elements most considered before investing were political risks, corruption, infrastructure weaknesses and contract enforcement problems.¹

In the face of unilateral contract cancelations, problems with import and export licenses and payment defaults, one would expect corporations to look for legal tools to solve disputes and

¹ North American firms were substantially more likely to cite contract enforcement as an investment constraint—47% compared to 37% in the sample as a whole.
claim their rights. Since courts are one of the main legal tools through which lay citizens and companies can enforce contracts, I chose to focus the present analysis on assessing the impact that the level of access to the legal system has on foreign investors’ decisions.

So far, the closest studies have assessed the relationship between a country’s contract enforcement capacity and FDI by using moral hazard, partial equilibrium models and game theory analysis; however, no regression analysis has been used to solely study this relationship. The present study confers this issue from a broader perspective which is a country’s level of access to the civil justice (ACJ). It not only assesses legal enforcement as a determinant of FDI but it also takes into consideration people’s awareness about legal remedies, people’s capacity to afford legal counsel and disputes, and the existence of alternative dispute resolution mechanisms, in addition to the other commonly used factors in the literature such as transparency, impartialness and effectiveness of the judicial system.
Chapter I: Access to Civil Justice and Development

There is some consensus in the international development literature that poverty reduction and equitable economic development depend on the solid foundation of the rule of law (Maru 2009). As a key component of the rule of law, access to civil justice plays a major role in attaining these goals by giving people the power to protect and exercise their rights as citizens and economic actors.

Access to the legal system gives identity and voice to the poor. It allows them to have legal identity, enforce their contracts, repeal discriminatory laws, and empower marginalized groups such as indigenous peoples and women. Moreover, access to civil justice provides marginalized groups with equal opportunity to enter local, national, and international markets, and protects them from unfair situations such as wrongful eviction, expropriation, extortion and exploitation (CLEP 2008).

Although there is no clear causality between development and access to civil justice, legal empowerment provides a useful framework for examining the main drivers of development today: governance and poverty reduction (Banik 2009). Over four billion people currently live without legal protection; therefore, is not surprising that ongoing efforts to reduce poverty have resulted in a new strategy encompassing legal considerations such as land rights, collective rights, and reforms targeted at creating more efficient judicial systems to operate in conjunction with greater socio-economic equity (Banik 2009).

FDI is one of the principal components of capital flows and technological progress in developing countries, and attracting foreign capital is a commonly implemented approach to achieve
economic growth. In turn, as mentioned before, access to civil justice and contract enforcement provide a useful framework to achieve development. In order to assess the relationship between these factors and find out if there is in fact a positive correlation between a developing country’s legal framework and FDI, I conduct a regression analysis relating both variables of interest.
Chapter II: Literature Review: Is there an empirical link between Access to Civil Justice and Foreign Direct Investment?

On the past, economic development literature using regression analysis has focused on identifying the characteristics of public institutions that matter to attract foreign direct investment (FDI). The data used to measure this relationship often include the effectiveness, independency and transparency of legal systems. However, none of this data encompasses people’s access to the judicial system as a determinant of FDI.

Earlier studies have assessed a similar relationship which is the relationship between a country’s contract enforcement capacity and FDI by using moral hazard, partial equilibrium models and game theory analysis. So far, however, researchers have not used regression analysis to study the relationship between contract enforcement and FDI. Theory in this relationship is divided. Some researchers defend contract enforcement as a determinant of FDI; but others contend that there is no clear relationship between the two factors.

Among the first group, a common proposition in that contract enforcement is a key component of civil justice and is essential for investment, trade and sustained economic growth (Montesquieu 1748) Cooley (2004), for example, argues that economies with lower enforceability of contracts are characterized by greater macroeconomic volatility and North (1990) suggested that the inability of societies to develop effective and low cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World. Similarly, (Tao, 1998) suggests that one of the long-run deterrents to foreign direct
investment is the weak enforcement of binding contracts. There are several reasons to believe this. First, foreign companies want to ensure that they can legally enforce binding contracts whenever joint venture counterparts and national providers are not meeting their legal commitments. Thus a poor enforceability of contracts can represent a high risk to the company. Second, investors always look for favorable credit conditions which tend to be less accessible when they invest in countries with weak contract enforceability. Scholte (2010) tested this possibility, using a random effects regression with data from the Loan Pricing Corporation. He found that banks charge higher interest rates when they are lending to firms operating in countries with weak creditor rights and poor enforcement.

Another finding suggests that contract enforcement, including binding the multinational itself, makes the multinational better off (Markusen, 2001). Using a double-sided moral hazard model, the author found that in fact there is some truth in the view of developing countries that contract enforceability only enriches the multinationals and requires the poor countries to pay more to acquire products such as pharmaceuticals and software. However, he recognized that this finding depends on the initial situation, and whether or not there is always inward investment in the absence of strong investor protection.

As noted above, however, some researchers reject the notion of a link between contract enforcement and FDI. A thesis researchers contend is that investors do not consider host legal systems when they locate their investment overseas, but their decision is rather affected by economic and social factors such as the economy and market size and each country’s cultural
background (Perry 2005). For instance, within civil law countries, where there is more procedural formalism than in other legal systems, it is common to find high levels of investment (e.g. France) which suggests that other more appealing conditions drive investor’s decisions.

Using a two-period double-moral-hazard model, Tao (1998) found not only that long legal procedures do not matter affect foreign investor’s decisions, but contract enforcement is often an unnecessary tool since foreign investors prefer non-binding contracts. This finding was supported by Kadity (2003) who showed -using a game theory analysis - how a non - binding contract can be suitable for the early stage of economic transition. However, she observed that strict contract enforcement may be still necessary later as the economy develops. Also, Nunn (2005) -using a partial equilibrium model - concluded that when investments are relationship-specific, underinvestment\(^2\) will occur if contracts cannot be enforced.

So far, there is no econometric evidence in the literature solely aimed to find a relationship between FDI and contract enforceability or FDI and access to civil justice. A close analysis conducted by Kinoshita (2003) -using a panel data 1990-1998 for 25 transition economies- concluded that countries with good institutions attract more inflows of FDI. With high scores of the rule of law, he asserted that investors’ rights will be more likely to be protected; however the author did not look for the specific relationship between the access to civil justice and FDI neither the relationship between contract enforcement and FDI.

\(^2\) A situation in which a company refuses to make low-risk investments to the detriment of bondholders.
In a more detailed, focused analysis, Knack and Keefer (1995), using an OLS regression method, tested the relationship between institutions, investment, and growth. Their variables included the Repudiation of Contracts by Government variable from the Country Risk Guide Index (ICRG), and the Enforceability and Infrastructure Quality variable from the Business Environmental Risk Intelligence. They found that institutions that protect property rights are crucial to economic growth and investment.

Finally, studying the link between institutions and FDI, Bénassy-Quéré, Coupet, and Mayer (2005) found that contract law and security of property rights among other elements have a direct and positive effect on foreign direct investment. They used the Institutional Profile database constructed by the French Ministry of Finance network for 52 foreign countries for year 2001.

The present study:

The contribution of the present investigation results from two main features. First, I use the Rule of Law Index component, Access to Civil Justice (ACJ) as a variable of interest; and second, will conduct a two stage least square (2 SLS) regression to test for its level of association with FDI. In addition, I apply the same method to assess the influence of contract enforcement on FDI and interact this factor with GDP to test the effect based on each country’s development stage.

As constructed, the Access to Civil Justice factor combines eight different components in a single number: 1) People are aware of available remedies, 2) People can access and afford legal counsel in civil disputes, 3) People can access and afford civil courts, 4) Civil Justice is
impartial, 5) Civil justice is free of improper influence, 6) Civil justice is not subject to unreasonable delays, 7) Civil justice is effectively enforced and, 8) Alternative Dispute Resolution mechanisms (ADRs) are accessible, impartial and effective. The range of the index goes from 0 to 10 where 0 means weak access and 10 strong access.

In addition, to assess the relationship between contract enforcement and FDI, and test whether my results are consistent with the literature, I use three variables: 1) The Good Governance Index component Contract Enforcement, from the PREM World Bank data, which refers to the number of formal independent procedures to collect a debt; 2) Days to Enforce a Contract from the World Bank Development Indicators which measures the number of calendar days from the filing of the lawsuit in court until the final determination and, in appropriate cases, payment; and 3) Procedures to Enforce a Contract, from the same source, which measures the number of independent actions, mandated by law or courts, that demand interaction between the parties of a contract or between them and the judge or court officer.³

³ Variables 1 and 3 are alike. I ran the regression with each to test for any differences.
Chapter III: Descriptive analysis

At first sight there is no relationship between FDI and ACJ as shown in figure Nº 1 which displays simple correlation plots between foreign direct investment and ACJ for a set of 35 countries.

---

Figure Nº 1

Access to Civil Justice vs Foreign Direct Investment: 35 countries, 2009

In addition, none of the three contract enforcement variables seems to affect FDI in the scatter plot diagrams shown in figures 2, 3 and 4. FDI tends to be more concentrated at lower number of days to enforce a contract, as well as at a small number of procedures to enforce a contract (See figures 2 and 3); but the slope of the fitted line is very small in all cases indicating no relationship between the variables.
Figure Nº 2

Time to Enforce Contracts vs Foreign Direct Investment: 35 countries, 2009

Figure Nº 3

Good Governance Contracts Enforcement Indicator vs Foreign Direct Investment: 32 countries, 2009
Finding no apparent preliminary correlation between the variables of interest does not display the whole picture; and thus the importance of conducting an econometric analysis. For instance, the fact that the economy’s competitiveness may absorb most of the variability in the FDI variable may cause other independent variables to show no correlation at first sight, as shown in the previous exhibits. In order to find out if that is in fact the case, I perform the following quantitative steps.
Chapter IV: Quantitative Strategy:

Section 1: Quantitative approach

Having shown at first glance what both relationships look like, I will run an econometric model to isolate the impact of the access to civil justice and contract enforcement on foreign direct investment, controlling for other factors or competing explanations. Due to the special features of the rule of law data (cross section for 2009), I use a cross country analysis. This approach has been widely used in economics and other social science; however, it has certain inherent limitations, for example, being able only to capture limited variability. Cross country data only allows determining the effect of the explanatory variable in a static time; however, is not enough for capturing the true impact between variables over time.

Another problem, also present in panel data is endogeneity. Having data for only a single year makes it very difficult to attribute causation. To tackle this problem it is necessary to ensure that enough other factors influencing FDI are held fixed and that instrumental variables are being used when necessary to make a case for causality and avoid endogeneity problems.

In the present case, endogeneity results from the fact that while GDP is an important determinant of FDI flows (Dunning 1993), FDI is in turn one of the principal components of capital flows and technological progress, and thus a great contributor to GDP growth. To tackle this problem and in order to guarantee a one way direction in the measured relationship, I use the ‘Distance to Ecuador’ as an instrument for GDP.
I also considered the possibility of encountering endogeneity problems between ACJ and FDI, and contract enforcement and FDI. To deal with this potential issue, I used ‘Legal Origin’ and ‘Mortality rates expected by the first European settlers in the colonies’ as instrumental variables for ACJ and contract enforcement. However, neither instrumental variable is incorporated in the final results because I found insufficient evidence to make a case for endogeneity between the variables of interest.

To select the instrumental variable for each case, I verified that each met two elemental conditions: First, its correlation with the X is it an instrument for and second, that they are uncorrelated with the error term. The following brief analysis was made for each instrument:

To instrument for GDP:

Distance to Ecuador: At first glance the first condition is met as shown in Figure Nº 5. With the exception of one outlier, the correlation between a country’s distance to the Ecuador and its level of GDP seems to be very strong. In terms of the second condition, I did not find any evidence of unobservable elements influencing FDI that were also correlated with distance to Ecuador.
To instrument for ACJ:

*Legal Origin:* Legal origin is the foundation of each country’s legal system. Therefore, as a logical derivation of the legal system, the access to civil justice has an intrinsic correlation with legal origin. Regarding the second condition, one could anticipate that a country’s level of corruption is correlated with legal origin (Mahoney 2001) and that legal origin can also affect a country’s financial development (La Porta et al. 1997, 1998; and Acemoglu and Johnson 2003). If corruption is in fact a deterrent of FDI and legal origin influences financial performance, then one of the conditions of having a good instrument would be violated.

*Mortality rates expected by the first European settlers in the colonies:* This concept was proposed as instrument for current institutions. Acemoglu (2011) explains the rationale behind for using this data as an instrument, as follows:
ACJ is an important aspect of the quality of judicial institutions. Thus, settler mortality rates was an instrument worth to consider for the present analysis.\(^4\) Regarding the second condition, there was not enough evidence to establish that unobservable elements influencing FDI were correlated with any of the two instruments.

To tests if the relationship between the variables of interest holds and test if there is any level of causality using instrumental variables, I used a two stage least square (2 SLS) regression (See model in p.18). This method allows controlling for omitted variables that might be influencing FDI and that are not included in the model; for example, regulation, freedom from corruption and monetary freedom.

Section 2: Data report and descriptive statistics

This paper uses the new Rule of Law Index from the World Justice Project (WJP) 2010 to examine the effect of a country’s access to civil justice on FDI inflows. The index is one of the most comprehensive data sets measuring the extent to which countries adhere to the rule of law from the perspective of the lay citizen. Thus, it provides a very useful tool for researchers to assess the effect of inherent rule of law components on different policy outcomes.

The WJP data was gathered using exactly the same methodology from all 35 countries: 1) A general population poll, using 1,000 respondents per country in the three largest cities for a total

\(^4\) \textit{Eurfrac} which is measured by the fraction of people in each country speaking European a language, and \textit{Engfrac} which is the fraction of people speaking English in each country where also considered as instruments for ACJ.
of 35,000 respondents; and 2) 900 qualified respondents to a total of 700 questions to measure all the information. The sample is divided in four groups: 5 countries at the low-income level, 12 at the lower middle, 7 at the upper middle, and 11 at the high income level. The consistency in the methodology, allows for lower margins of error, a higher level of confidence (95%) to interpret the results, feasible comparison between variables since reference groups are the same, and non-existent overlapping of confidence intervals.

No single index is perfect and as such, the access to civil justice component of the rule of law has to be interpreted in light of some limitations. Thus, the WJP notes that the Index data are not sensitive enough to identify binding constraints in specific countries, or specific priorities for reform in countries and across the globe. Second, that the Index data are not intended to establish causation or to ascertain the complex relation among different rule of law dimensions in various countries. Third, it notes that the Index’s data are subject to measurement error. Fourth, that specific rule of law concepts measured by the Index may have different meanings across countries. Fifth, that the index was designed to track the “temperature” of the rule of law situation of countries in a manner that is both consistent and systematic; but it is not powerful enough to provide a full diagnosis or to dictate concrete priorities for action. (World2010)

The basic question I seek to address is whether a country’s access to civil justice affects the country’s inward direct investment. The model used for this analysis is as follows:
$Lnfd = \beta_0 + \beta_1 Ptax + \beta_2 LnGdp + \beta_3 Daysbuss + \beta_4 Acj + \beta_5 Proprights + \beta_6 Rigemp + \beta_7 Infl + \varepsilon$

Where:

Lnfdi: Foreign Direct Investment, net inflows (% of GDP) in log form. Year 2009, WB Development Indicators.

Ptax: Amount of taxes on profits paid by the business as a percentage of commercial profits in constant form. Year 2009, WB Doing Business Data.

LnGdp: Gross Domestic Product Per Capita, adjusted for purchasing power parity (PPP) measured in (constant 2005 int$), in log form. Data from 2009. WB Development Indicators.

Daysbuss: Days to start a business. Time involved in launching a commercial or industrial firm with up to 50 employees and start-up capital of 10 times the economy's per-capita gross national income (GNI). Year 2009. WB Doing Business Data.

Acj: Access to Civil Justice, measured from 0 to 1 in constant form. Year 2009, World Justice Project Data.

Proprights: Ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state in constant form. Year 2009, Economic Freedom Index, Heritage Foundation (HF).

Rigemp: Employment Rigidity Index. Measures the average of three sub-indices: a difficulty of hiring index, a rigidity of hours index and difficulty of hiring index in constant form. Year 2009. WB Doing Business Data.

Infl: Average inflation consumer prices (annual %) 2000-2009. WB Development Indicators.

$\varepsilon$ = Unexplained variance, error term
\[ \beta_0 = Y - \text{intercept} \]
\[ \beta_0, \beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7 = \text{Independent variables coefficients} \]

I used logarithms to turn GDP and FDI into a linear function and allow for an easier interpretation. Under this form the relationship can be interpreted in percentage change, where GDP measures the elasticity of FDI inflows. The rest of the variables are measured in constant terms.

I also ran the same model replacing ACJ with my three different contract enforcement variables:

**Dayset**: Number of calendar days from the filing of the lawsuit in court until the final determination and, in appropriate cases, payment, WB, 2009.

**Pec**: Number of independent actions, mandated by law or courts, that demand interaction between the parties of a contract or between them and the judge or court officer, WB, 2009

**Ctenf**: The indicator of contract enforcement refers to the number of formal independent procedures to collect a debt derived from questionnaires answered by attorneys at private law firms. Year 2002. Good Governance Index indicator, World Bank.

**Variables of Interest:**

The dependent variable Foreign Direct Investment, are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor calculated as a % of the host country’s GDP. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as
shown in the balance of payments. The source for this data is The World Bank, World Development Indicators; the data and is available for 35 countries in 2009.

To measure a country’s access to civil justice I use factor eight from The Rule of Law Index for 2009. Access to Civil Justice is composed of the following factors: 1) People are aware of available remedies, 2) People can access and afford legal counsel in civil disputes, 3) People can access and afford civil courts, 4) Civil justice is impartial, 5) Civil justice is free of improper influence, 6) Civil justice is not subject to unreasonable delays, 7) Civil justice is effectively enforced and ADRs are accessible, impartial, and effective.

To measure the time to enforce a contract I use two different variables. First, the number of calendar days from the filing of the lawsuit in court until the final determination and, in appropriate cases, payment, from the World Bank Development Indicators (2009); and second, the number of formal independent procedures to collect a debt derived from questionnaires answered by attorneys at private law firms from the Good Governance Index indicator, World Bank (2002).

To measure the number of procedures to enforce a contract I use the number of independent actions, mandated by law or courts, that demand interaction between the parties of a contract or between them and the judge or court office, from the World Bank Development Indicators (2009). See Table Nº 1 for a summary of variables.
Control variables:

One control variable that is consistently present in the FDI literature is GDP. It is presumed that countries with higher GDP have lower costs for all producers in the market due to economies of agglomeration (Globerman 2002) and this may attract FDI. Another reason to think that growth induces foreign investment is the fact that investors feel more attracted to high-value-added sectors, larger and more profitable firms, and firms with low debt, which are usually more prevalent in countries with a minimum threshold of economic growth. The problem with using GDP as a control variable is the positive correlation of this variable with wages. In principle we assume that high wages discourage foreign investors’ decisions and therefore GDP might not always have a positive relationship with FDI. However, the relationship between wage rates and GDP per capita is frequently statistically insignificant (Altomonte 2000). Therefore, this study will follow the FDI literature and include this measure as a control variable. Since I anticipate GDP to be correlated with other explanatory variables, I will tackle potential multicollinearity and endogeneity bias by systematically comparing the estimations with and without GDP per capita.
capita. For this study, I will use the GDP per capita, adjusted for purchasing power parity (PPP) measured in constant 2005 int$, in log form from the World Bank (World Development Indicators).

In terms of macroeconomic conditions, another variable that has been used in the literature besides GDP is the country’s average inflation. Theory suggests that inflation influences foreign investment especially through its impact on the cost of capital (Auerbach and Jorgenson 1980). To control for this effect, I will use average inflation between 2007 and 2009 from the World Bank (World Development Indicators), as measured by the consumer price index, reflecting the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly.

I anticipate that the ability of people to accumulate private capital also influences investment decisions. To measure this policy element I will use the Property Rights Index from the Index of Economic Freedom (IEF) developed by the Heritage Foundation (HF). The index measures the degree to which a country’s laws protect private property rights and the degree to which its government enforces those laws. The data I will use is for the year 2009 and is available for all 35 countries of this study.

In addition to the enforcement of property rights laws, I will also control for the easiness to start a business in the countries of analysis. In some countries the official cost of entry is too high, discouraging companies from starting new businesses. For example, to operate a business in
Mozambique, an entrepreneur must complete 19 procedures taking at least 149 business days, and pay US$256 in fees, whereas an entrepreneur in Canada can finish the process in 2 days by paying US$280 in fees and completing only 2 procedures. (Djankov2002). These differences in procedures I believe will reveal a great difference in where investors place their resources. To control for this effect I will use the Procedures to Start a Business variable from the World Bank (Doing Business Data). This variable includes all procedures that are officially required for an entrepreneur to start up and formally operate an industrial or commercial business. These data are available for year 2009 and for all 35 countries. It is important to highlight that this variable captures information for small and medium-sized enterprises within the host countries; and it may not reflect the way enterprises analyses their investment risk.

The difficulty of hiring people in a host country should also have an impact on FDI. To control for this effect I will use the World Bank’s Employment Rigidity Index for 2009, which averages three sub-indices: a difficulty of hiring index; a rigidity of hour’s index; and difficulty of hiring index. The data are available for all 35 countries.

Another key element influencing foreign direct investment is the level of taxation of the recipient country. Conceptually, the appropriate measure to use would be the marginal effective tax rate (Globerman 2002). However, due to the limited number of observations used in the present study the variable was not used since the data were missing for El Salvador, Jordan, Liberia and Morocco. To avoid this problem, I used another tax measure that could potentially influence foreign investors’ decisions - the amount of taxes on profits paid by the business as a percentage
of commercial profits in 2009 (from Doing Business). These data are available for all 35 countries.

In order to determine if there is any correlation between the independent variables, I used a correlation matrix in which 1 indicates the highest level of correlation and 0 represents no correlation at all. As shown in Table Nº 2 (See appendix) there is a high correlation between the access to civil justice and the gross domestic product. This is a predictable result since one would anticipate that at higher income levels, the justice system is more developed and thus, more access to the population is provided. I also find correlation between days to enforce a contract and property rights variables. This correlation is not surprising, since, besides measuring the degree to which a country’s laws protect private property rights and the degree to which its government enforces those laws, the variable property rights also assesses the ability of individuals and businesses to enforce contracts.

In addition, there are four moderate correlations. First, the correlation between property rights and the access to civil justice; second, the correlation between GDP and inflation; third, the correlation between inflation and access to civil justice; and fourth, the correlation between the levels of property rights and the procedures to start business. It is not surprising that the third correlation is negative since one would expect that at sustained increasing rates of inflation, the worse off the economy would be and thus, the judicial services may decrease in quality and access. By the same logic, I expect that a country with strong property rights protection would influence the incorporation of effective procedures for people who acquire properties or develop
new ones. It is necessary to highlight that none of these moderate correlations present a problem for the current analysis and do not raise multicollinearity problems.

The data comes from 35 different countries in 7 regions. Table Nº 2 displays the sample’s distribution across the regions:

### Table Nº 2

<table>
<thead>
<tr>
<th>Region</th>
<th>Freq.</th>
<th>Percent</th>
<th>Cum.</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia and Pacific</td>
<td>7</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Eastern Europe and Central Asia</td>
<td>5</td>
<td>14.29</td>
<td>34.29</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>7</td>
<td>20</td>
<td>54.29</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>2</td>
<td>5.71</td>
<td>60</td>
</tr>
<tr>
<td>South Asia</td>
<td>2</td>
<td>5.71</td>
<td>65.71</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>5</td>
<td>14.29</td>
<td>80</td>
</tr>
<tr>
<td>Western Europe and North America</td>
<td>7</td>
<td>20</td>
<td>100</td>
</tr>
</tbody>
</table>

The sample is also divided in four different income levels: low income, lower middle, upper middle and high as shown in figure Nº 6.

### Figure Nº 6
Section 3: What to expect from the Cross-Country regression analysis?

Giving companies the opportunity to go to formal institutions to claim their civil rights, gives investors much more confidence to do businesses since ensures that any non-compliance by host agents can be claimed and enforced through the legal system. This rationale leads to the supposition that countries with greater access to the judicial system are likely to be seen by foreign investors as less risky. These anticipated results are consistent with the existent literature which, while it has not focused on the influence of access to civil justice on foreign direct investment, has provided general insights about the importance of quality of institutions, including the judicial system, to attract foreign investment.
Chapter V: Results

Table C (See appendix) summarizes the results from two stage least square regression analysis of the cross-country relationship between the level of a country’s access to civil justice and the amount of its foreign direct investment received for 2009, using conventional data employed in existing works addressing the determinants of foreign direct investment, and new data not used before such as the Access to Civil Justice factor from the Rule of Law Index (World Justice Project 2010).

The table indicates that the correlations between FDI and the amount of taxes on profits paid by the business as a percentage of commercial profits in constant form, days to start businesses, and GDP per capita, adjusted for purchasing power parity (PPP) measured in (constant 2005 int$) in log form are significant at the 0.01% level.

The direction of all the relationships is consistent with the anticipated results except for the relationship between FDI and GDP which is negative. One explanation may be the market type for which foreign investors place their capital. For instance, oil, coal and other natural resources represent a large portion of foreign investment. Thus, the fact that these resources are usually located in countries with low GDP may be the explanation why FDI is more concentrated at lower levels of economic growth. Another justification may be the positive correlation of GDP with wages. In principle we assume that high wages discourages foreign investor’s decisions, therefore, this would explain why GDP did not show to have a positive relationship with FDI.

Conversely, the results show that the relationship between ACJ and FDI is weak and not significant which confirms the preliminary findings of the descriptive analysis.
Tables D, E and F (See appendix) summarize the results using the same model and method but replacing ACJ with the three contract enforcement variables: time to enforce contracts, procedures to enforce contracts and contract enforcement respectively.\(^5\) Like the ACJ variable, all of the new variables included in the model have weak and non-significant correlation with FDI; and the specifications for taxes on profits, days to start businesses and GDP per capita in log form, still appear to be influential and significant at the 0.01% level. However, the property rights, employment rigidity and inflation variables, are not statistically significant in any of the results. Interestingly, when including days to enforce a contract, rigidity of employment becomes significant at the 0.001% level.

The empirical results show that neither ACJ, time to enforce a contract or number of procedures to enforce a contract, influence FDI. There may be different methodological reasons why the hypothesis could not be confirmed.

The main constraint present throughout the analysis is the limited number of observations used. Only 35 countries where included in my sample; a number close to the minimum accepted in the regression analysis literature to capture sufficient variability in the model. This limitation leads to a second problem which is the minimum number of variables that a model has to have relative to the amount of observations. It is commonly accepted in the regression analysis literature that in order to obtain better estimates, a model has to have at least 10 observations for each variable.

\(^5\) Good Governance Indicator
In this case, ACJ appeared to be not statistically significant possibly because thirty five observations were too few for ACJ to be included in the base model. Furthermore, the limited number of observations also make it more difficult to capture differences within countries when using dummy variables. When a dummy is included in a model, it is usually hard to capture variability. In this case, when I included region dummies to control for the differences between countries, the problem was accentuated due to the small number of observations.

Another problem could have been unobservable variables correlated with foreign direct investment. This raises the concern of having independent variables correlated with the error term resulting in spurious correlations. Since we cannot assume that any of the Xs are correlated with $u$, it is difficult to assume that the distribution of $u$ is independent of the Xs and, therefore, the error term may exhibit heteroskedasticity (Wooldridge 2009).

Endogeneity is also a limitation commonly present in cross country analysis. In FDI prediction models, the commonly present endogeneity problem has to do with the independent variable GDP. As mentioned earlier, GDP is an important determinant for FDI flows, and FDI is in turn, one of the principal components of capital flows and technological progress and thus a great contributor to GDP growth. In order to fix this problem and ensure one way direction, I followed the literature and used distance to the Ecuador to instrument for this variable.
Anticipating the possibility of encountering endogeneity problems between ACJ and FDI, I used legal origin as an instrument for ACJ. However, despite the close relationship between the legal origin variable and ACJ, as mentioned earlier, legal origin could be correlated with corruption (Mahoney 2009) and also could affect the country’s financial development (La Porta et al. 1997, 1998, Acemoglu and Johnson 2003). If given either case, then the exclusion restrictions may be violated and the instrumental variable estimates are inconsistent biasing the results (Nunn 2007).

In addition, correlation problems between the contract enforcement variables and with property rights and between GDP and the access to civil justice variable might have also caused biased results. Finally, other methodological shortcomings such as measurement error and incorrect variable specifications could have also have had an impact on the regression analysis findings.

Conversely, it is plausible that methodological shortcomings are not the reason for these findings; but instead other intuitive explanations may justify the results. For example, the finding may be supported by the fact that firms prefer greater flexibility in case market conditions change (Gow2000). In which case, businesses might prefer non-binding contracts, and thus might not rely much on enforcement mechanisms. Another explanation for why ACJ does not affect corporate investors is that they often look for private enforcement mechanisms rather than courts which are usually less efficient. Arbitration, a private mechanism designed for companies and individuals to resolve commercial disputes is an example of a commonly used alternative. Although the ACJ data incorporates the existence of Alternative Dispute Resolution (ADR) mechanisms, it is possible that the index did not capture the existence of ADRs for corporations
since the data is gathered from the perspective of lay citizens whose awareness about corporate legal issues may be limited.

In the case of the relationship between contract enforcement and FDI there are also intuitive explanations to justify the results. In fact, the empirical evidence coincides with a portion of the literature that suggests that contract enforcement does not matter in attracting FDI. By using a double-sided moral hazard model, Tao (1998) found not only that long legal procedures do not determine foreign investor’s decisions, but also that contract enforcement is often an unnecessary tool since foreign investors prefer non-binding contracts.

This finding also coincides with the one explained by Kadity (2003) who showed using a game theory analysis- how a non-binding contract can be suitable for the early stage of economic transition. In addition to this finding, she also observed that strict contract enforcement may still be necessary later as the economy develops. In order to test for this prediction, I interacted GDP with each of the contract enforcement variables to test whether contract enforcement matters depending on the economic development stage of each country. However, none of the contract enforcement variables was significant; trough could be explained by the limited data variability which could be seriously restraining the explanatory power of the interaction.

The empirical findings agreed with the portion of the literature that suggests that foreign businesses prefer non-binding contracts, and thus do not rely much on enforcement mechanisms. However, the findings are inconsistent with the portion of the literature that suggests that
contract enforcement matters as the economy develops. As mentioned before, and assuming that would be the case, the methodological and data limitations earlier discussed may have been the cause of the inconsistency of the results.
Chapter VI: Conclusion and Policy Implications

The results of this study do not support my hypothesis that increased access to civil justice increases a country’s inward foreign direct investment. As mentioned earlier, there are two reasons why that might have been the case. First, methodological shortcomings might have biased the results, and second, corporations’ decisions are simply not affected by the people’s access to the judicial system, since corporations prefer using alternative dispute resolution mechanisms to solve their differences with host agents and contract flexibility to operate.

The fact that the present study did not find empirical evidence of a relationship between people’s access to courts and a country’s capacity to attract foreign capital, does not mean in any sense that further efforts to strengthen the legal systems and provide equal access to people are unnecessary. As mentioned earlier, access to the legal system gives identity and voice to the poor and provides marginalized groups with equal opportunity to enter local, national and international markets. Legal empowerment provides a key framework that supports the main drivers of development today: governance, and poverty reduction (Banik 2009). Thus ensuring legal rights is an effort that cannot be resigned.

For the purpose of enriching the research on the institutional determinants of attract foreign investment, it would be fascinating to conduct investigations on other rule of law elements as determinants of FDI, such as how limited are government powers, absence of corruption, clear,
publicized and stable laws, order and security, fundamental rights, open and transparent government, regulatory enforcement, and informal justice.

It would be also very interesting to see which other engines of development are influenced by access to civil justice and enforcement of contracts. For example an interesting subject to look at would be microfinance to see whether borrowers’ credit is affected when they lack the capacity to enforce contracts and access the courts.
Appendix

Table A

<table>
<thead>
<tr>
<th></th>
<th>acj</th>
<th>ptax</th>
<th>daysbuss</th>
<th>gdp_log</th>
<th>rigemp</th>
<th>propri-s</th>
<th>infl</th>
<th>daysct</th>
<th>ctenf</th>
<th>pec</th>
</tr>
</thead>
<tbody>
<tr>
<td>acj</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ptax</td>
<td>-0.1245</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>daysbuss</td>
<td>-0.3887</td>
<td>0.1387</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>gdp_log</td>
<td>0.8150</td>
<td>-0.1893</td>
<td>-0.4429</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>rigemp</td>
<td>-0.2801</td>
<td>-0.2768</td>
<td>0.2984</td>
<td>-0.1852</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>propri-s</td>
<td>0.6340</td>
<td>0.1948</td>
<td>-0.2662</td>
<td>0.4239</td>
<td>-0.3554</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>infl</td>
<td>-0.3912</td>
<td>0.0359</td>
<td>0.0287</td>
<td>-0.5500</td>
<td>-0.0369</td>
<td>-0.2405</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>daysct</td>
<td>-0.2926</td>
<td>-0.0304</td>
<td>0.1935</td>
<td>-0.3495</td>
<td>0.1252</td>
<td>-0.2122</td>
<td>0.0058</td>
<td>1.0000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ctenf</td>
<td>-0.4957</td>
<td>-0.2097</td>
<td>0.3429</td>
<td>-0.4024</td>
<td>0.2907</td>
<td>-0.6216</td>
<td>0.0985</td>
<td>0.2782</td>
<td>1.0000</td>
<td></td>
</tr>
<tr>
<td>pec</td>
<td>-0.8153</td>
<td>0.0503</td>
<td>0.4408</td>
<td>-0.7016</td>
<td>0.3323</td>
<td>-0.4496</td>
<td>0.2734</td>
<td>0.5096</td>
<td>0.4518</td>
<td>1.0000</td>
</tr>
</tbody>
</table>

Table B

<table>
<thead>
<tr>
<th>Variable</th>
<th>Obs</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>fdi_log</td>
<td>35</td>
<td>.8384621</td>
<td>1.109432</td>
<td>-1.709258</td>
<td>3.764356</td>
</tr>
<tr>
<td>ptax</td>
<td>35</td>
<td>17.37429</td>
<td>8.368686</td>
<td>0</td>
<td>33.1</td>
</tr>
<tr>
<td>gdp_log</td>
<td>35</td>
<td>9.124439</td>
<td>1.168139</td>
<td>5.884947</td>
<td>10.73591</td>
</tr>
<tr>
<td>daysbuss</td>
<td>35</td>
<td>19.94286</td>
<td>13.11699</td>
<td>2</td>
<td>50</td>
</tr>
<tr>
<td>acj</td>
<td>35</td>
<td>.582</td>
<td>.142639</td>
<td>.28</td>
<td>.83</td>
</tr>
<tr>
<td>propri-s</td>
<td>35</td>
<td>52.42857</td>
<td>23.92917</td>
<td>20</td>
<td>90</td>
</tr>
<tr>
<td>infl</td>
<td>35</td>
<td>5.686994</td>
<td>5.069063</td>
<td>-3.3</td>
<td>23.6</td>
</tr>
<tr>
<td>pec</td>
<td>35</td>
<td>35.42857</td>
<td>5.740904</td>
<td>21</td>
<td>47</td>
</tr>
<tr>
<td>daysct</td>
<td>35</td>
<td>610.1143</td>
<td>294.4635</td>
<td>150</td>
<td>1420</td>
</tr>
<tr>
<td>ctenf</td>
<td>32</td>
<td>23.3125</td>
<td>8.931414</td>
<td>10</td>
<td>47</td>
</tr>
</tbody>
</table>

35
### Table C

**Table x. OLS Results of Basic Model**

**Dependent Variable: Ln Foreign Direct Investment**

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4 Access to</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax rate as a percentage of profit</td>
<td>-0.0612***</td>
<td>-0.0595***</td>
<td>-0.0487***</td>
<td>-0.0512***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0205)</td>
<td>(0.0188)</td>
<td>(0.0175)</td>
<td>(0.0168)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ln GDP</td>
<td>-0.366*</td>
<td>-0.552**</td>
<td>-0.0365***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.207)</td>
<td>(0.215)</td>
<td>(0.0123)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Days to start a business</td>
<td>-0.0384***</td>
<td></td>
<td>-0.973**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0132)</td>
<td></td>
<td>(0.464)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to Civil Justice</td>
<td></td>
<td></td>
<td>4.543</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(3.182)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Rights</td>
<td></td>
<td></td>
<td>-0.00472</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rigidity employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>0.2134</td>
<td>0.296</td>
<td>0.426</td>
<td>0.463</td>
<td>0.205</td>
<td>0.323</td>
<td>0.331</td>
</tr>
<tr>
<td>N</td>
<td>35</td>
<td>35</td>
<td>32</td>
<td>32</td>
<td>32</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.2134</td>
<td>0.296</td>
<td>0.426</td>
<td>0.463</td>
<td>0.205</td>
<td>0.323</td>
<td>0.331</td>
</tr>
</tbody>
</table>

Notes: *** $p < 0.01$; ** $p < 0.05$, * $p < 0.001$

### Table N° D

**Table x. OLS Results of Basic Model**

**Dependent Variable: Ln Foreign Direct Investment**

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4 Time to</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax rate as a percentage of profit</td>
<td>-0.0612***</td>
<td>-0.0595***</td>
<td>-0.0487***</td>
<td>-0.0528***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0205)</td>
<td>(0.0188)</td>
<td>(0.0175)</td>
<td>(0.0172)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ln GDP</td>
<td>-0.366*</td>
<td>-0.552**</td>
<td>-0.596***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.207)</td>
<td>(0.215)</td>
<td>(0.231)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Days to start a business</td>
<td>-0.0384***</td>
<td></td>
<td>-0.0363***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0132)</td>
<td></td>
<td>(0.0126)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Time to enforce a contract</td>
<td>-0.000726</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.000618)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Rights</td>
<td></td>
<td></td>
<td>-0.00472</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rigidity employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-0.00865</td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>0.0328</td>
<td></td>
<td>0.0328</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>35</td>
<td>35</td>
<td>32</td>
<td>32</td>
<td>32</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.2134</td>
<td>0.296</td>
<td>0.426</td>
<td>0.406</td>
<td>0.205</td>
<td>0.323</td>
<td>0.331</td>
</tr>
</tbody>
</table>

Notes: *** $p < 0.01$; ** $p < 0.05$, * $p < 0.001$
### Table E

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax rate as a percentage of profit</strong></td>
<td>-0.0612***</td>
<td>-0.0595***</td>
<td>-0.0487***</td>
<td>-0.0521***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0205)</td>
<td>(0.0188)</td>
<td>(0.0175)</td>
<td>(0.0164)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Ln GDP</strong></td>
<td>-0.366*</td>
<td>-0.552**</td>
<td>-0.606***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.207)</td>
<td>(0.215)</td>
<td>(0.229)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Days to start a business</strong></td>
<td>-0.0384***</td>
<td>-0.0296**</td>
<td></td>
<td>-0.0581</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0132)</td>
<td>(0.0117)</td>
<td></td>
<td>(0.0385)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Procedures to enforce a contract</strong></td>
<td></td>
<td></td>
<td></td>
<td>-0.00472</td>
<td>-0.00865</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.00803)</td>
<td>(0.0109)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Property Rights</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-0.00472</td>
<td>-0.00865</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.00803)</td>
<td>(0.0109)</td>
<td></td>
</tr>
<tr>
<td><strong>Rigidity employment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-0.00472</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.00803)</td>
<td></td>
</tr>
<tr>
<td><strong>Inflation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0.0328</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.0377)</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>35</td>
<td>35</td>
<td>32</td>
<td>32</td>
<td>32</td>
<td>32</td>
<td>32</td>
</tr>
<tr>
<td><strong>R²</strong></td>
<td>0.296</td>
<td>0.426</td>
<td>0.206</td>
<td>0.205</td>
<td>0.323</td>
<td>0.331</td>
<td></td>
</tr>
</tbody>
</table>

Notes: *** p < 0.01; **p < 0.05, *p< 0.001

### Table F

<table>
<thead>
<tr>
<th>Predictor</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax rate as a percentage of profit</strong></td>
<td>-0.0612***</td>
<td>-0.0595***</td>
<td>-0.0487***</td>
<td>-0.0518**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0205)</td>
<td>(0.0188)</td>
<td>(0.0175)</td>
<td>(0.0236)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Ln GDP</strong></td>
<td>-0.366*</td>
<td>-0.552**</td>
<td>-0.658*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.207)</td>
<td>(0.215)</td>
<td>(0.379)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Days to start a business</strong></td>
<td>-0.0384***</td>
<td>-0.0384***</td>
<td>-0.0148</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0132)</td>
<td>(0.0251)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Contract enforcement</strong></td>
<td></td>
<td></td>
<td></td>
<td>-0.00472</td>
<td>-0.00865</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.00803)</td>
<td>(0.0109)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Property Rights</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-0.00472</td>
<td>-0.00865</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.00803)</td>
<td>(0.0109)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Rigidity employment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-0.00472</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.00803)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Inflation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0.0328</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.0377)</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>35</td>
<td>35</td>
<td>32</td>
<td>32</td>
<td>32</td>
<td>32</td>
<td>32</td>
</tr>
<tr>
<td><strong>R²</strong></td>
<td>0.296</td>
<td>0.426</td>
<td>0.206</td>
<td>0.205</td>
<td>0.323</td>
<td>0.331</td>
<td></td>
</tr>
</tbody>
</table>

Notes: *** p < 0.01; **p < 0.05, *p< 0.001
Nunn, Nathan. 2007. Relationship-Specificity, Incomplete Contracts, and the Pattern of Trade* 

Banik, Dan. 2009. Legal Empowerment as a Conceptual and Operational Tool in Poverty 
Eradication. *Hague Journal on the Rule of Law* 1, no. 01 (March): 117. 
doi:10.1017/S1876404509001171. 
http://www.journals.cambridge.org/abstract_S1876404509001171.


Acemoglu, Daron, Simon Johnson, and James A Robinson. 2011. The Colonial Origins of 
Comparative Development : An Empirical Investigation 91, no. 5: 1369-1401. 

Botero, Juan Carlos, Judge Roger Errera, Charles Fried, Oliver Hart, Roumeen Islam, Simon 

4: 817-847.


Kaditi, Eleni. Multinational investment, intra-industry trade and contracts in transition economies: A case study for food-industries.


www.elsevier.nl / locate /econbase


Wooldrige, Jeffrey M. 2009. Introductory Econometrics, A Modern Approach, 4e