RELATIONSHIP BETWEEN CORRUPTION AND FDI INFLOW: A CAUSALITY TEST

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Abstract: *This research paper aims at (1) testing the direction of causality between corruption and the inflow of foreign direct investment FDI, and (2) estimating the strength (magnitude) of the relation between the two variables. The researchers could not find in the literature an agreement on either the direction or on the strength of such a relationship. In order to test the research hypothesis, a sample of 37 countries is used, 19 OECD (developed) countries and 18 developing countries. The countries in each of these two groups were chosen by picking the ones with the highest GDP growth rates over the past three years. A time series data set (2006 – 2015) for each of the selected countries has been used. After performing the stationarity test and the required transformation, the Granger causality test has found that causality took one direction from corruption to FDI inflow. Then, the regression of FDI inflow on corruption (and other control variables), has shown the following results:*

1. *In each of the groups; developed (OECD) and developing countries, the effect of corruption on FDI inflow was negative and very significant.*
2. *The strength (magnitude) of this effect was higher in case of OECD countries than in the case of developing countries.*
3. *Despite this weakness of the effect in developing countries, it continued to be a negative effect. The hypothesis of "greasing the wheels of business", which was reported in literature review, does not seem to be supported in this research. There is not enough empirical support for the claim that corruption can grease the business wheels and thus can increase the inflow of the foreign direct investment.*

Key words: *corruption, FDI inflow, causality test*

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