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DEMOCRACY, GOVERNANCE, ECONOMIC FREEDOM, AND FOREIGN DIRECT INVESTMENT

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ABSTRACT

Objective: To analyze how much democracy, economic freedom and governance influence the flow of direct external investments in countries, considering the Population Index and Gross Domestic Product (GDP) *per capita* as control variables. **Method:** Statistical analysis through structural equation modeling that made it possible to simultaneously analyze multiple variables in 144 countries on six continents, from 2008 to 2018. **Main Results:** It was confirmed that democracy, economic freedom, and governance influence the flow of direct external investments and how much each of them does so. Another finding is that the size of the population has a greater influence than the independent variables studied. **Relevance / Originality:** Previous studies have devoted themselves to analyzing the impact of one or other factors on the flow of direct external investments, but the results among the studies remain controversial. **Theoretical / Methodological Contributions:** The article used the method of modeling structural equations, which allowed us to analyze how much variables influence the flow of direct external investments. No articles were found that analyzed these variables together and how much each influenced the flow of direct external investments in the countries. **Social Contributions / Contributions to the Management:** Foreign direct investment contributes to the development of the countries that receive these investments, understanding which factors are most attractive to investors allows countries to adopt policies and develop more assertive actions.

INTRODUCTION

With the intensification of globalization, Foreign Direct Investment (FDI) has increased exponentially as world production has dispersed to developing countries, resulting in more liberal policies (Li & Resnick, 2003). According to the World Bank, this movement made it the main element in the global economy (Jensen, 2003) and one of the most effective tools against poverty (Asiedu & Lien, 2011). However, FDI does not necessarily go where there is a greater lack of investment but to economies that present a more favorable environment for conducting business (Pearson et al., 2012). Therefore, the capitalism/ democracy binomial remains controversial. If, on the one hand, it is possible to admit that democratic econ-

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omies tend to be capitalist, on the other hand, it is difficult to accept that capital flows follow the logic of seeking democratic environments. In this study, we propose a set of variables to understand how FDI has behaved since the 2008 economic crisis and in the following ten years.

It is possible to assume that economies that understand which factors influence the choice of investors and how will be able to develop more assertive actions to become attractive. This being a relevant and complex topic, several researchers address different factors, correlations, and methods to answer this question, since the importance of these investments in countries is a consensus among authors, especially in developing countries.

Although studies related to the flow of FDI focus on market attractiveness variables, such as size and Gross Domestic Product (GDP), few studies jointly relate the role of criteria related to economic freedom, democracy, and quality of the governance indices of the country in which the investment takes place. Previously published studies have linked increased economic growth with FDI (Azman-Saini et al., 2010; Azman-Saini et al., 2013; Iamsiraroj, 2016; Lim, 2001; Pegkas, 2015), including this analysis with institutions and governance (Alemu, 2018; Besley, 1995; Busse and Hefeker, 2007; Dawson, 1998; Globerman and Shapiro, 2003; Jensen, 2008; Kurul and Yalta, 2017) and with economic freedom (Azman-Saini and Baharumshah, 2010; Bengoa and Sanchez-Robles, 2003; Hafer, 2013; Pearson et al., 2012; Quazi, 2007; Sambharya & Rasheed, 2015).

Other studies focus on factors that influence FDI, such as country risk (Rafat and Farahani, 2019), democracy (Jensen, 2003; Lacroix et al., 2017; Li, 2009a; Li et al., 2018), in developed countries (Li and Resnick, 2003; Resnick, 2001), in developing countries (Choi and Samy, 2008; Durmaz, 2017), regime types (Choi, 2009), economic freedom and democracy (Kazemi & Azman-Saini, 2017) and also the influence of the availability of natural resources (Alfalih and Hadj, 2020; Asiedu and Lien, 2011).

Therefore, our objective in this study was to simultaneously analyze the influence of democracy, governance, and economic freedom indices on the flow of FDI, having as control variables the Population Index and GDP *per capita*. To this end, we carried out descriptive statistical research, comprising an analysis using structural equation modeling. It allowed us to examine a series of dependency relationships simultaneously and to analyze multiple variables in more complex contexts (Hair et al., 2005), considering 144 countries with data available in the databases between 2008 and 2018.

The results of this research indicate that the analyzed variables — democracy, governance, and economic freedom — are significant. However, they partially explain why countries attract FDI. As a research finding, we can highlight the Population Index, which proved to be the most significant variable among those studied and used as a control variable. Some studies address market size or population as attractive to investors. Nevertheless, most address political and economic factors, such as economic freedom, regime types, country risk, and governance.

Regarding economic freedom, governance, and democracy, even if they seem to be linked, nothing prevents non-democratic regimes from offering economic freedom and some type of institutional organization in order to attract FDI (Azman-Saini et al., 2013). According to The Heritage Foundation (2020), the economic freedom index in 2020 presented a record in the global average score in 26 years, with 124 of the 180 economies classified in the index. The index registered an increase in economic freedom, in contrast to the Democracy Index of The Economist Intelligence Unit, which found that 2018 recorded the worst global average score since 2006.

We have organized this study into sections. After this introductory part, the article presents its theoretical foundation, anchored in the themes of democracy, governance, economic freedom, and FDI. The following section presents the methodological procedures that guided the research. Then, the results of the analysis are presented and discussed. Finally, the last section presents the conclusion of the study.

1. THEORETICAL FOUNDATION AND PROPOSITION OF HYPOTHESES

1.1. Democracy

Democracy is "a representative political regime in which impartial elections choose the political leaders of the national state" (Chase-Dunn & Lerro, 2016, p. 3). It guarantees citizens the participation of all in choosing governments more focused on their needs by incorporating governance systems and institutions with greater transparency, legitimacy, and accountability (Emerson et al., 2012). Countries with a fully democratic political culture have effective governments with guaranteed political and civil liberties. The judiciary and the media are independent, and laws are enforced and obeyed (Economist Intelligence Unit, 2020).

Another crucial aspect of the deliberative democratic model is its existence in a continuous, inconclusive, and unfinished process. Furthermore, it is not a peaceful construction but one based on conflict. However, the antagonistic visions that are indispensable to forming policies presuppose a commitment, a mutual and temporary commitment between different points of view (Dalaqua, 2017). For there to be economic development, the democratic model must be supported by citizenship, that is, by citizen participation in the elaboration and application of public policies (Medina, 2016).

Concerning FDI, even though democracy presupposes more economical and political freedom and potentially more efficient laws and policies, it can positively influence many aspects. For instance, on attracting investments (Biglaiser & Staats, 2010; Choi, 2009; Jensen, 2003), studies by Choi and Samy (2008), Li (2009b), Li et al. (2018), Li and Resnick (2003) and Resnick (2001) demonstrated that the type of regime is not determinant in the choice of the country by the investor, or even has a negative impact, in the case of presenting bureaucratic procedures that hinder the entry of investment, as proposed in hypothesis 1: The democracy index of a given country is positively related to its ability to attract FDI.

Since the first hypothesis supports already known elements in international business, we develop other hypotheses. They are structured in the following topics to understand more clearly how this happens and what pillars can explain the relationship between democracy and FDI, especially relating them to those with governance and economic freedom.

1.2. Governance

The term governance can have several meanings, depending on the context (Gomes & Merchán, 2017). Generally, it refers to governing, whether in the public or private sector (Emerson et al., 2012). Still, it can be defined as all modes of governing, whether they are developed and applied by markets, hierarchies, governments, or networks (Termeer et al., 2010). The type of relationship between shareholders in the business world, self-regulation schemes in the public sphere, United Nations (UN) multilateral organizations, or governance of the global financial system are just a few examples (Gomes & Merchán, 2017).

The World Bank (2020) considers governance the process by which governments are chosen, replaced, and monitored. Governance is about the state's and citizens' respect for the institutions responsible for social and economic interactions between them and the government's ability to develop and implement sound policies for the country's development. This understanding will be the definition that will be considered in the article, since the objective is to analyze how the economic aspects of countries behave under the bias of democracy and governance. Still, from an epistemological point of view, the institutionalist approach to governance is the one that best fits the definition used in this research. These definitions are aligned with those proposed by the publishing source of the Governance Index of the Worldwide Governance Indicator.

Governance is an essential element of democracy and can be understood as a system or means whose ultimate goal is social well-being. It also presupposes a balance between political actors identified as citizens, rulers, and public managers in this environment. Governance seeks best practices within specific policy contexts. It considers popular participation, civic engagement, and the relationship between the actors to be essential (Gomes & Merchán, 2017). Consequently, governing encompasses all social, political, and administrative activities of actors who seek to guide, direct, control, or manage the pursuit of common welfare (Termeer et al., 2010).

Within the context of collective action, governance can be considered a dimension that jointly determines which norms and rules are created to regulate individual and collective behavior. They are meant to guide the process that influences decisions and actions in the public, private, and civic spheres. More specifically, governance is a set of coordinated and monitored activities that enable the observance of the collaborative association between societies and institutions (Termeer et al., 2010).

Strong institutions provide an enabling environment for private sector growth, building trust through transparent, effective, inclusive, and accountable practices (World Bank, 2018). Thus, institutions, through good governance, can have a positive impact on FDI, as they can ensure the property right, protect against expropriation, and facilitate economic transactions between the parties in order to increase the return on investment (Dawson, 1998), inhibit corruption (Kazemi & Azman-Saini, 2017) and enable strategies to promote economic freedom (Quazi, 2007). Based on the perception of the role of governance in FDI, the second hypothesis is proposed: The factors associated with the governance of a given country are positively related to its ability to attract a flow of FDI.

1.3. Economic freedom

Economic freedom can be conceptualized as the freedom that individuals have to produce, work, consume, invest, and own their property, without the government having to coerce the free circulation of goods, labor, and capital, in addition to the necessary action to maintain one's freedom (Heritage Foundation, 2020). Friedman (1962) argues that economic freedom promotes political freedom, that a free market already protects personal freedom, offering goods, labor, and information, and that any free bilateral transaction only happens if it benefits both parties.

Several researchers observed a strong relationship between economic freedom and economic growth (Doucouliagos & Ulubasoglu, 2006). In addition to finding a strong relationship between economic freedom and economic growth, they also demonstrated that economic growth was more significant than political freedom. Fabro and Aixalá (2012) found that factors such as political freedom, civil liberties, and the quality of institutions help explain the different patterns across countries. Baier et al. (2012), Hafer (2013), Levine et al. (2000), and Shehzad and De Haan (2009) analyzed that countries with higher levels of economic freedom have greater financial development, reducing the probability of a banking crisis, resulting in more significant economic growth and an increase in *per capita* income.

Economic freedom also diminishes transaction costs, reducing the risk of economic transactions and making them more attractive to international investors (Egger & Winner, 2004). Quazi (2007) points out that the internal investment climate of the countries receiving the investments influences the decision of investors. They may prefer to invest where companies have more freedom to manage in the way they see fit, to import goods, capital, and even workforce, and will have facilities to export their production. In addition to maintaining the free market, countries that respect property rights are more attractive to receive FDI (Caetano & Caleiro, 2009; Gwartney et al., 2011).

Friedman and Friedman (1999) argue that property rights are fundamental to economic freedom. Countries with guaranteed property rights are more likely to receive FDI. In general, democracies guarantee this right more; Friedman and Friedman (1999) reinforce that property rights cannot be sustained without democracy. This perspective aligns with Li (2009a), who showed that autocratic regimes are more likely to practice expropriation than democratic countries.

Friedman (1962) understands that political and economic freedom, or the free market, are inseparable. Some studies argue that economic freedom alone does not guarantee investments if it is not complemented by good-quality democracy (Addison & Heshmati, 2003; Blanton & Blanton, 2007). Other studies demonstrate that the democratic regime can discourage investors (Li & Resnick, 2003; Resnick, 2001). Kazemi and Azman-Saini (2017) simultaneously related economic freedom and democracy and found that the former is sufficient to attract FDI. However, it should be noted that many countries can offer economic freedom without being democratic, receiving significant amounts of FDI (Kazemi & Azman-Saini, 2017). Given this evidence, the third hypothesis of this study is proposed: Economic freedom in a given country is positively related to the factors influencing its ability to attract a flow of FDI.

1.4. Foreign Direct Investment

According to the United Nations on Trade and Development (UNCTAD, 2019), FDI is considered to be any long-term foreign capital contribution to participate in a country's domestic productive structure. The investment can remain indefinitely in the country depending on the investor's interest, who may be an individual or a legal entity, implying foreign influence in the company's management.

FDI flows have grown in recent decades. There are more expressive growth rates than those of international trade due to the decentralization of the global production process, providing more importance to the branches of foreign companies in the structures of international trade, sales, and production (UNCTAD, 2019). FDI promotes technological advances, research and development, and know-how to recipient countries, offering increased financial resources, productivity, specialized labor, and access to foreign markets (Iamsiraroj, 2016).

For all this, most developing and developed countries adopt policies to attract FDI, exacerbating competition for these flows, which leads to more demands for investments than offers (UNCTAD, 2019). In 2018, FDI in developed countries declined, reaching the lowest point since 2004 (UNCTAD, 2019). The flow to developing countries remained stable, even with a slight increase; with that, the share of developing markets in FDI increased to 54%, an unprecedented index (UNCTAD, 2019).

Countries need to be aligned with the interests of investors to attract FDI. Therefore, analyzing the aspects that influence the choice is a recurrent subject among researchers. Several previous studies related the influence of one or more factors, such as democracy, economic freedom, and governance with FDI, such as Alfalih and Hadj (2020), Asiedu and Lien (2011), Azman-Saini and Baharumshah (2010), Bengoa and Sanchez-Robles (2003), Choi (2009), Choi and Samy (2008), Hafer (2013), Durmaz (2017), Jensen (2003), Kazemi and Azman-Saini (2017), Li (2009b), Li (2018), Li and Resnick (2003), Resnick (2001), Pearson et al. (2012), Quazi (2007), Sambharya and Rasheed (2015), among others.

Different factors were also identified as influencing the choice of investment location, such as economy of scale, market structure, political and economic stability, market size and growth, infrastructure, and country risk (Busse & Hefeker, 2007). Yuqing (2006) observed that China received FDI because of the size of its market and exchange rates. Akin (2009), Billington (1999), and Chakrabarti (2001) concluded that the size of the market influences the choice of investors, especially in developing countries. However, the Population Index is more important than the GDP *per capita* indicator, which is usually used to measure the market size and growth. For this reason, both the population ratio and GDP *per capita* must be routinely included in surveys of investment flows as control variables.

Based on the hypotheses, the proposed model can be represented by the Figure 1.

2. METHODOLOGICAL PROCEDURES

This study aimed to analyze the influence of democracy, governance, and economic freedom on FDI flows. The methodology is descriptive, with a quantitative approach applied through secondary data.

The analyzed sample was limited to the countries available in all databases, making a total of 144 countries, representing 74% of all countries, considering data from 2008 to 2018 (the last years available in all databases). Still considering the data available per country annually, the number of 1,584 valid observations was obtained (data from 144 countries for 11 years), thus not considering missing data.

2.1. Dependent variable

The dependent variable considered in the research was the World Bank FDI index, which refers to the flows of FDI in the reporting economy, considered the sum of social capital, reinvestment of profits, and other foreign capital (World Bank, 2020). To determine the existence of FDI, the World Bank index considers the cross-border investment associated with an investor who has a significant degree in the management of a company from another country, and the investor must own at least 10% of the shares of the company's share capital (World Bank, 2020). The data presented are annual and are in US dollars.

2.2. Independent variables

2.2.1. Democracy

In this study, democracy was quantified using Democracy Index of The Economist Intelligence Unit. The index has been released since 2006 and provides a portrait of the state of democracy in 167 countries, which is used by companies, banks, academic institutions, and governments to analyze global changes and manage risks and opportunities (Economist Intelligence Unit, 2020). In addition, the results are presented and analyzed by region through an annual report (Economist Intelligence Unit, 2020).

This index, which is presented annually, differs from other scales by presenting sub-items to represent different levels of regimes and can be considered more comprehensive and sensitive than other scales (Coppedge et al., 2011). The component variables are based on what The Economist Intelligence Unit defines as fundamental to democracy, developed by its experts through 60 indicators from global surveys of values grouped into five categories (Walker et al., 2015): electoral process and pluralism, civil liberties, the functioning of government, political participation and political culture (Walker et al., 2015). Data are presented annually.

2.2.2. Governance

Another independent variable used was the annual World Bank governance index. The index is built on more than 30 adjacent data sources scaled into six aggregated indicators (World Bank, 2020). Entitled Worldwide Governance Indicators (WGI), they present data since 1996, and their measurement unit ranges from -2.5 to 2.5, meaning that the higher the value, the better the governance (World Bank, 2020). They are:

- Voice and accountability: Considers the perception of how much a country's citizens participate in choosing their government and their freedom of expression, association, and free media (World Bank, 2020).
- Political stability and non-violence: Measures the perception of the probability of instability in the government, by unconstitutional means or violence, based on terrorism or political motivation (World Bank, 2020).
- Government effectiveness: Comprises the perception of the quality of public and civil services, their degree of independence from political pressures, and the quality in formulating, implementing, and crediting public policies (World Bank, 2020).

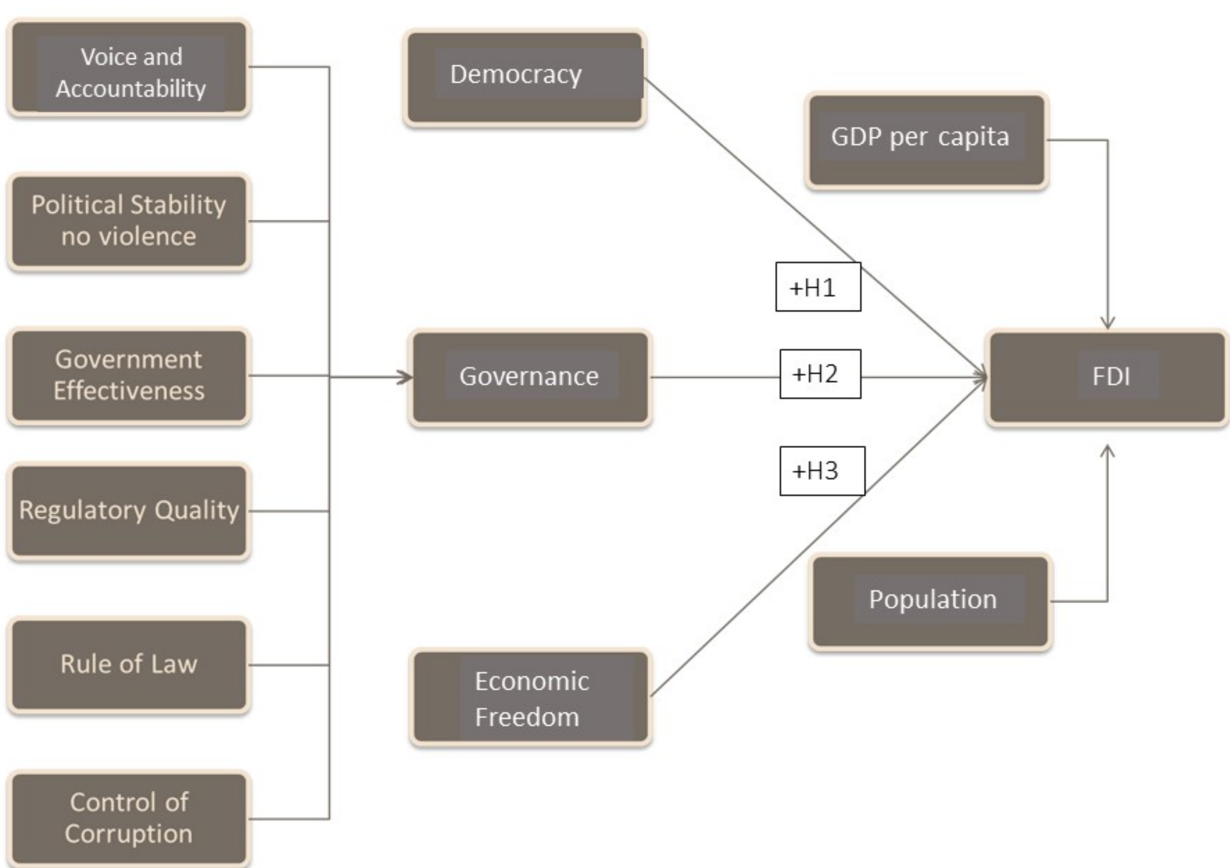

Figure 1. Research Model.

- Regulatory quality: Consists of the perception of the government's ability to formulate and implement consistent policies that promote the development of the private sector (World Bank, 2020).
- The rule of law: Refers to the perception of the level of reliability and respect for society's rules, especially in the enforcement of contracts and property rights, the quality of public security, both in the police and in the courts, and the likelihood of violence and crime (World Bank, 2020).
- Control of corruption: Captures the perception of the extent to which public power is used for private gain and how this is used by elites and private interests (World Bank, 2020).

2.2.3. Economic freedom

The third independent variable considered was The Heritage Foundation's Economic Freedom Index. The index started in 1995 in partnership with the *Wall Street Journal* and analyzed 186 economies worldwide (Heritage Foundation, 2020). As it is considered a reliable index, it is used to analyze the development of countries and the medium and long-term effects of policies adopted on economic freedom and the domestic investment climate (Quazi, 2007).

2.3. Control variables

Control variables establish an environment or context in which the independent and dependent variable relationship is established (Marconi & Lakatos, 2000). The variables considered in this research are the GDP and the population of each country in the respective years considered (2008 to 2018). World Bank indices were used.

As described by the World Bank (2020), GDP is the sum of all final goods and services produced by a country, plus taxes and minus subsidies, not included in the value of products, and is commonly used to analyze the size of economies across countries and check how much the country has produced and is producing. GDP *per capita* is gross domestic product divided by population (World Bank, 2020).

The population size of countries was also analyzed in this study. The first author to relate population density and FDI was Billington (1999). According to her, population density implies more consumers and more available labor. Many studies correlate the Population Index with GDP *per capita* to measure the market size (Busse & Hefeker, 2007; Chakrabarti, 2001; Yuqing, 2006).

2.4. Analysis procedures

Data were tabulated in an electronic spreadsheet and imported into the statistical software IBM® Statistical Package for the Social Sciences (SPSS). Afterward, a descriptive analysis of the independent, dependent, and control variables was carried out using the mean, median, and standard deviation and box plot analysis.

The Democracy Index was evaluated on a scale ranging from 0 to 10, the Economic Freedom Index on a scale from 0 to 100, the Governance Index on a scale from-2.5 to 2.5, and the FDI in absolute values in US dollars. Control variables were evaluated in absolute numbers. Due to differences in the measurement scale, the variables were standardized. The Governance Index was calculated from the six variables that compose it, using the factorial score to generate the referred index.

A bivariate correlation matrix was created to test the existence of collinearity, using all the variables under study. To classify the intensity of the correlation, we used the proposal by Mukaka (2012), in which correlations below 0.3 are considered negligible; from 0.3 to 0.5 are considered weak; from 0.5 to 0.7, moderate, from 0.7 to 0.9, strong; and above 0.9, very strong. A second collinearity test was performed using the Variance Inflation Factor (VIF) contained in the regression test, considering the absence of collinearity coefficients below 5 (Hair et al., 2005).

We used the statistical technique of multiple linear regression with the stepwise method to test the proposed objective. The regression weights (β) and the significance of the relationship were observed using the p-value to determine the influence of the independent and control variables on the dependent variable. Significant relationships present a p-value less than 0.05 (Hair et al., 2005).

3. RESULTS

A total of 1,584 observations were analyzed, divided into 144 countries chosen by the availability of data in all research bases: The Economist Intelligence

Unit, WGI, The Heritage Foundation and World Bank, in the period from 2008 to 2018.

Table 1 shows the descriptive analysis of the data.

In order to understand the concentration of data based on the median, the box plot was used, shown in Figure 2.

Regarding the Democracy and Governance Indexes, it appears they present a homogeneous distribution around the median, with no countries in specific periods that stand out in these indices (outliers).

Concerning FDI, it is observed that Brazil, China, Ireland, Netherlands, the United Kingdom, and the United States received investments higher than the other countries analyzed between 2008 and 2018. Notably, in 2015 and 2016, the United States received the most investments, while in 2018, the Netherlands, which was among the countries with the highest investments, became the country with the lowest level of FDI.

Regarding economic freedom, there is homogeneity in the data concerning the median, emphasizing only Cuba and Zimbabwe, which present extreme values (outliers) for the lowest level of economic freedom.

It is also noted that countries such as Luxembourg, Norway, Switzerland, Finland, and Qatar have the highest GDP *per capita* in the analyzed period, with the entry of Singapore in 2015. Finally, in terms of population, the United States, Russia, and Mexico are the most populous countries, with extreme values for China and India. On the other hand, Turkey is the least populous country.

A bivariate correlation matrix was created to verify the relationship between the variables, shown in Table 2.

According to Table 2, the Democracy Index is negligibly correlated with FDI, moderately correlated with economic freedom and GDP *per capita*, and strongly with the Governance Index. The Democracy Index does not correlate with the population.

Economic freedom, in addition to a moderate correlation with the Democracy Index, has the same type of correction with GDP *per capita* and a strong correlation with the Governance Index. The Governance Index, in turn, strongly correlates with GDP *per capita*.

FDI, on the other hand, has a negligible correlation with the Democracy Index, Governance Index, and economic freedom and has a weak correlation with the population and GDP *per capita*. In contrast, the population has a negative and negligible correlation with the Governance Index, economic freedom, and GDP *per capita*.

We used multiple linear regression with the stepwise method to test the hypotheses proposed in Figure 1, shown in Table 3.

As you can see, all independent and control variables were significant for the presented model. We started with the analysis of the model's coefficient of determination (R^2), as this coefficient is used as one of the measures to assess the quality of adjustment (Maroco, 2007). In this research, the adjusted R^2 value presented a total result of 0.31, which ensures that the model is capable of predicting a variance of 31% in the relationship between the set of independent and control variables on the dependent variable. The reference values for this indicator depend on the subjectivity of the study; a parameter greater than 0.25 is accepted (Maroco, 2010).

Table 1. Descriptive analysis of the variables under study.

Descriptive	Governance Index	Economic Freedom	Democracy Index	Foreign Direct Investment (US$)
Sample	1,584	1,584	1,584	1,584
Missing values	0	0	0	0
Mean	-0.01	61.18	5.73	13,461,059,948.96
Median	-0.24	60.60	5.94	1,393,400,000.00
Standard deviation	0.89	10.48	2.15	43,346,189,757.33
Minimum	-1.75	21.40	1.26	- 239,337,011,214.71
Maximum	1.87	90.20	9.93	509,087,000,000.00

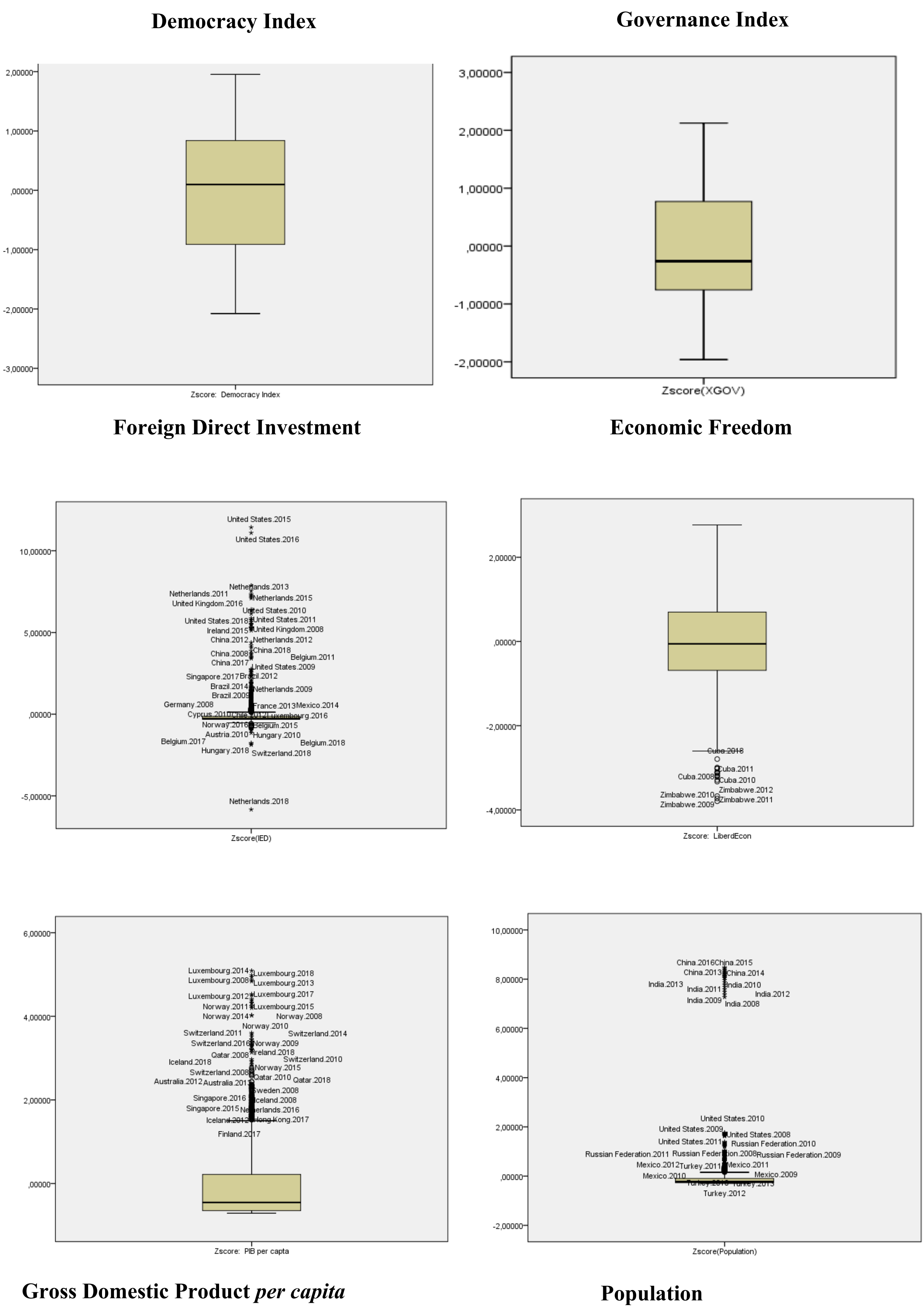

Figure 2. Box plot.

The Population Index's control variable appears to be the most important in the model, explaining 18% of the FDI variance. This explanation indicates that even in adverse conditions of democracy, governance, or economic freedom, investments take place. GDP *per capita* presented the regression weight at $\beta = 0.20$, increasing the explanatory power of FDI by 9%.

In turn, economic freedom presented $\beta = 0.116$, the third most important variable in the model, increasing the explanatory power of FDI by 1%.

Table 2. Bivariate correlation matrix.

Variables	Democracy Index	FDI	Economic Freedom	Governance Index	GDP per capita
Democracy Index	1				
FDI	0.191**	1			
Economic Freedom	0.665**	0.259**	1		
Governance Index	0.845**	0.287**	0.836**	1	
GDP per capita	0.573**	0.311**	0.644**	0.796**	1
Population	-0.010	0.424**	-0.087**	-0.061*	-0.059*

FDI: Foreign Direct Investment; GDP: Gross Domestic Product. *Correlation is significant at the 0.05 level (2-tailed); **correlation is significant at the 0.01 level (2-tailed).

Table 3. Hypothesis testing through linear regression: stepwise.

Models		Standardized Coefficient	t	Sig. (p-value)	Collinearity Statistics		R	R^2	Adjusted R^2
		Beta			Tolerance	VIF			
1	(Constant)		0.00	1.00			0.42	0.18	0.18
	Population	0.42	18.59	0.00	1.00	1.00			
2	(Constant)		0.00	1.00			0.54	0.29	0.29
	Population	0.44	20.93	0.00	1.00	1.00			
	GDP *per capita*	0.34	15.90	0.00	1.00	1.00			
3	(Constant)		0.00	1.00			0.55	0.30	0.30
	Population	0.45	21.37	0.00	0.99	1.01			
	GDP *per capita*	0.25	9.06	0.00	0.59	1.71			
	Economic Freedom	0.14	5.03	0.00	0.58	1.71			
4	(Constant)		0.00	1.00			0.55	0.31	0.30
	Population	0.45	21.53	0.00	0.99	1.01			
	GDP *per capita*	0.27	9.43	0.00	0.55	1.83			
	Economic Freedom	0.18	5.66	0.00	0.45	2.21			
	Democracy Index	-0.08	-2.58	0.01	0.52	1.92			
5	(Constant)		0.00	1.00			0.56	0.31	0.31
	Population	0.46	21.66	0.00	0.99	1.01			
	GDP *per capita*	0.20	5.44	0.00	0.33	3.05			
	Economic Freedom	0.11	2.79	0.01	0.29	3.44			
	Democracy Index	-0.16	-3.92	0.00	0.25	4.01			
	Governance Index	0.205	2.952	0.003	0.090	11.083			

VIF: Variance Inflation Factor; GDP: Gross Domestic Product. Dependent Variable: Foreign Direct Investment.

The Democracy Index had a significant relationship with FDI, but its influence is negative and contributes 1% of the explanatory power. This result means that the more democracy, the less FDI.

Finally, the Governance Index showed $\beta = 0.20$, but its collinearity coefficient, assessed by VIF, is equal to 11,083. VIF values greater than 5 indicate that the variable is highly correlated with the others included in the model. Therefore, its contribution to explaining the FDI variance is close to zero.

4. RESULTS AND DISCUSSION

The model's result, in general, aligned with previous studies. Some exciting elements were found, such as the index's expressive result relative to the population's size, whose importance had been highlighted in some studies, and the negative coefficient of the democracy index, which corroborates some articles and disagrees with others.

However, no previous studies were found that encompassed democracy, governance, economic freedom, GDP *per capita*, and population in a single model, which simultaneously analyzed their influences on attracting FDI, despite being recurrent and interconnected themes.

As for the results, the Democracy Index (β =-0.16) indicates that the greater the democracy, the lower the FDI. This finding is also in line with the results reported in the work of Berden et al. (2014), Lacroix et al. (2017), Li (2009b), Li et al. (2018), Li and Resnick (2003). In addition, Lacroix et al. (2017) point out that there is a time that must be considered when a country declares itself a democracy and effectively becomes one. However, Jensen (2008) concluded that democracy contributes to reducing the political risk that positively impacts the entry of investments in countries; Choi and Samy (2008) found that there are some aspects in which democracy can positively influence FDI, but the subject is controversial. Choi (2009), in another study, concludes that democratic countries attract more FDI than autocratic countries if the outliers are analyzed. We, therefore, consider that hypothesis 1 was not supported since the results indicated that democracy is related to factors that negatively influence the flow of FDI in countries. Despite the significance of the results, the relationship is the opposite of what was expected.

The governance variable finds support in several other studies, whether regional or economic, such as Alemu (2018), Besley (1995), Busse and Hefeker (2007), Dawson (1998), Jensen (2008), who found elements that support the importance of governance for the flow of FDI. Globerman and Shapiro (2003) found, from the point of view of the US as an investor, similar evidence. Kurul and Yalta (2017) also highlighted the characteristics that make up the governance construct that influence the remittance of foreign exchange to other countries with the objective of long-term investment. However, these studies do not demonstrate the explanatory capacity of less than 1% in the composition of the FDI flow. Governance is significant, but it represents little in the analysis of foreign exchange remittances. In this way, hypothesis 2 can be considered supported since it can be related to the factors that positively influence the flow of FDI in countries.

Economic freedom had a $\beta = 0.116$. Economic freedom can be considered one of the most critical themes in attracting FDI. In this study, it was shown to have a lower index than the population, GDP *per capita*. Authors agree on its influence, both on investments and economic growth (Baier et al., 2012; Caetano & Caleiro, 2009; Doucouliagos & Ulubasoglu, 2006; Egger & Winner, 2004; Fabro & Aixalá, 2012; Gwartney et al., 2011; Hafer, 2013; Levine et al., 2000; Quazi, 2007; Shehzad & De Haan, 2009). Thus, hypothesis 3 appears to be true since economic freedom is related to factors that positively influence the flow of FDI in countries.

As for the control variables, GDP *per capita* and population, authors such as Akin (2009), Billington (1999), Busse and Hefeker (2007), Chakrabarti (2001), Lacroix et al. (2017), Lautier and Moreau (2012), Singh (2019), Yuqing (2006), found that the size of the market influences the choice of countries for FDI, especially in developing countries, as it allows for more labor supply and more consumers, and that the volume population influences more than GDP *per capita*. However, some authors use both indices to indicate the market size. This finding also appeared in the results of this study, but the contribution of this research is to present significant representativeness to the elements of the analysis.

CONCLUSION

Initially, this study aimed to analyze how much democracy, economic freedom, and governance influence the flow of FDI in countries, considering the Population Index and GDP *per capita* as control variables. It was concluded that many factors interfere with the choice of country for the remittance of capital with the objective of long-term investment. These factors are, for example, political stability, rates, labor qualification, economic openness, state regulation (Lautier and Moreau, 2012), and other factors listed throughout the article. Each may have greater or lesser influence depending on the investor, sector, and objectives (Lim, 2001). From the elaboration of this research, it was possible to analyze how some elements that compose the external capital flow equation behave.

The research bases were essential for the result of the proposed problem. Aligning them to the theoretical bases made it possible to reinforce concepts and verify how much these factors influence investors and their degree of importance combined.

According to Lacroix et al. (2017), there is a time gap between the country advancing in its economic and social indicators and effectively starting to receive currency as a long-term investment. This temporal lapse can blur the analysis and the short clipping used. To prevent this, we used ten years, delimited by the period available in the databases.

The study verified that all the indices used are in force, indicating that investors take these conditions into account when choosing the investing country. Among the degree of importance, the market size to be explored and the consumption potential became more relevant, followed by economic freedom, index of democracy, and governance.

It is essential to point out that the explanation coverage for this finding is 31%, representing a relevant contribution to the proposed relationships, especially for innovatively bringing the combined variables. This study contributes, therefore, to international business studies that focus on understanding the flow of FDI between countries, by proposing a multifaceted analysis that incorporates democracy, governance, and economic freedom into the same equation, controlling demographic and economic elements.

In managerial terms, this study is also innovative. While reinforcing that FDI contributes to the development of countries that receive these investments, it warns about the importance of understanding which factors are most attractive to investors. It allows public managers to develop more assertive policies and actions to attract investment, despite warning society that democracy alone does not support the attraction of investment, not least because the data indicate a negative relationship between FDI and democracy. Therefore, based on the findings of this article, decision-makers, whether in the public or private sphere, will be able to understand how and in what proportion the different factors act on the attractiveness of FDI in different regions of the globe.

Despite the relevance of the study, some limitations need to be highlighted. It invites researchers to look into the elements that make up the equation and others that may be considered relevant that were not evaluated here, such as the Gini Index. This index, created by Italian mathematician Conrado Gini, is an instrument to measure the degree of concentration of income in a given country. It is possible to assume that high levels of income concentration act negatively on attracting investments in countries with large populations, given that the population will have fewer financial resources available for consumption.

Finally, this work reveals that capital, represented by the flow of FDI, before assessing whether democratic environments, with good governance or economic freedom, evaluates the market potential concerning its size, both in terms of population and GDP, even if it means investing in countries with unsatisfactory democratic indices. Its importance lies in quantifying these elements and enabling the development of new research that can further help understand the complex movement of capital between countries.

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DEMOCRACIA, GOVERNANÇA, LIBERDADE ECONÔMICA E INVESTIMENTO ESTRANGEIRO DIRETO

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DETALHES DO ARTIGO

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RESUMO

Objetivo: Analisar o quanto a democracia, a liberdade econômica e a governança influenciam no fluxo de investimento estrangeiro direto nos países, considerando como variáveis de controle o índice populacional e o produto interno bruto *per capita*. **Método:** Análise estatística por meio da modelagem de equações estruturais, o que possibilitou examinar simultaneamente múltiplas variáveis em 144 países dos seis continentes no período de 2008 a 2018. **Principais Resultados:** Confirmou-se que a democracia, a governança e a liberdade econômica influenciam no fluxo de investimento estrangeiro direto e o quanto cada um deles contribui nessa equação. Outro achado foi que o tamanho da população possui maior influência do que as variáveis independentes estudadas. **Relevância / Originalidade:** Estudos anteriores dedicaram-se a analisar o impacto de um ou de outros fatores no fluxo de investimento estrangeiro direto, porém os resultados entre os estudos ainda permanecem controversos. **Contribuições Teóricas / Metodológicas:** Este estudo contribui para os estudos de negócios internacionais que se atêm a entender o fluxo de investimento estrangeiro direto entre os países, ao propor uma análise multifacetada que incorpora numa mesma equação democracia, governança e liberdade econômica, controlando elementos demográficos e econômicos. **Contribuições Sociais / para a Gestão:** O investimento estrangeiro direto contribui para o desenvolvimento dos países que recebem esses investimentos. Entender quais fatores são mais atrativos para os investidores permite que os países adotem políticas e desenvolvam ações mais assertivas. Assim, com base nos achados deste artigo, os tomadores de decisão sobre fluxos de investimento estrangeiro direto poderão entender como e em que proporção os diferentes fatores atuam sobre a atratividade de diferentes regiões do globo.

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