FDI IN RUSSIA:
WHY DOESN'T IT COME? SHOULD THERE BE MORE OF IT?

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This paper starts with a brief description of recent Russian economic and political developments and identifies the poor institutional capacity of the state as the major obstacle to growth. Then cross-country regressions are used to provide evidence for two arguments. *First*, the single most important factor limiting the inflow of FDI to Russia seems to be the inefficiency of the government – its inability to enforce rules and regulations. It is not the lack of the rule of law, or high corruption, or the insufficient democratization, or low degree of economic freedom. Foreign investors are attracted to Russia by its natural resources, relatively high degree of economic liberalization, and favorable FDI legislation, but there are scared away by the poor institutional capacity of the state. *Second*, under the circumstances of poor government effectiveness the benefits of FDI (addition to national investment, transfer of technology) are quite weak and may be outweighed by costs (repatriation of profits, "quick buck" orientation of investors). Building up institutional capacity – improving government effectiveness – should allow to kill two birds with one stone: attract more FDI and make sure this FDI is of high quality, i.e. conducive to economic growth.

Recent economic and political developments

After loosing 45% of its output in 1989-98, Russian economy started to grow from 1999 (6% in 1999, 10% in 2000, 4-7% in 2001-06) – the major push was given by devaluation of the ruble in 1998 and by higher world prices for oil and gas later, but Mr. Putin can at least take the credit for not ruining this growth. The government budget moved from a deficit to surplus, the decline in the share of state revenues and expenditure stopped, inflation fell from 84% in 1998 to 10% in 2006, government debt – internal and external – decreased, foreign exchange reserves increased.

True, in comparative perspective Russian performance is not that impressive. Many other former Soviet republics –Azerbaijan, Belarus, Estonia, Kazakhstan, Latvia, Lithuania,

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Turkmenistan, and Uzbekistan – by 2006 have reached or exceeded the pre-recession (1989) level of output, whereas Russian GDP was still only 85% of the 1989 level. Russian HDI – Human Development Index (accounting not only for GDP per capita, but also for life expectancy and the level of education) is still below the USSR level and even below that of Cuba with life expectancy of 77 years against 65 years in Russia. China with the life expectancy of 72 years is rapidly approaching the Russian level of HDI. But at least there is more stability in Russia today than in the rocky 1990s.

The government budget moved from a deficit to surplus, the decline in the share of state revenues and expenditure stopped, the government debt – domestic and external – decreased, foreign exchange reserves increased to over $250 billion by the end of 2006. The government created a Stabilization Fund to capture the windfall profits from fuel export that has reached over $80 billion by the end of 2006

Analysts, however, pointed out that given the increase of the world fuel prices in recent years, one could have expected an acceleration of economic growth, rather than a slowdown that actually occurred in 2001-06 as compared to 2000. The reason for the slowdown is the overvaluation of real exchange rate – the typical Dutch disease[2] that Russia developed once again. The first time Russia developed it in 1995-98 – this led to the currency crisis of August 1998, now it seems like history repeats itself. Optimists argue that unlike in 1998, Russia in 2006 had large foreign exchange reserves in the Central Bank and in the Stabilization Fund (over US$200 billion), but pessimists point out that if oil prices fall and capital starts to flee away at a rate of $5 billion a week, like it happened in July-August 1998, reserves would be depleted very quickly. The future devaluation could happen either in the form of the currency crisis or in the form of "soft lending", but there is hardly any doubt that eventually it would take place, even if oil prices would stay at the 2006 level of over $60 per barrel.

[2] The "Dutch disease" is the overdevelopment of the resource sector at the expense of the underdevelopment of other sectors, especially secondary manufacturing. It is observed in many, though not all, resource rich countries. Among many mechanisms that can lead to such an outcome, the most famous one is the overvaluation of real exchange rate due to high profitability of exports of resources; appreciation

Besides, current growth is not based on solid foundations: wages and incomes in recent years were systematically growing faster than productivity, so the share of consumption in GDP increased at the expense of investment. As a result, whereas Russian personal and public consumption has already exceeded the pre-recession level, investment is still below 40% of what it used to be in the last year of existence of the USSR. Russian gross savings are large – over 30% of GDP, but they are funneled away via the outflow of private capital and the accumulation of foreign exchange reserves, so gross investment amount only to less than 20% of GDP.

There is also another important deficiency of the current growth: the government in fact failed to use the windfall revenues from oil and gas exports in 2000-06 to repair the badly damaged state institutions and to restore the provision of crucial public goods, such as law and order, education, health care. Instead, the government was cutting tax rates, allowing the windfall revenues to precipitate into personal and business income, and accumulating the budget surplus, whereas the share of state spending in GDP virtually did not increase, remaining at an extremely low level of 1999 – two times lower than in the USSR.

For future political and social developments, the inevitable economic instability in the nearest years would be important, but perhaps less important than the dynamics of the institutional capacities of the state. The strong/efficient state is the one that has the power to enforce its rules and regulations, no matter what are these regulations. Crime/murder rate and the size of the shadow economy are natural objective measures of the strength of the state institutions. The strong state may be authoritarian or democratic - both China and Central European countries with the murder rates of about 2 per 100,000 inhabitants have stronger state than Russia with about 20-30 murders per 100,000 of inhabitants in recent decade.

The very notion of the state implies that public authorities exercise at least three monopolies: (1) on violence, (2) on tax collection, and (3) on money emission (coinage). All three monopolies were

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of real exchange rate undermines exports of all goods except resources, so deindustrialization of the economy occurs (see any textbook on “International Economics” for more details).

undermined in Russia during the 1990s to such an extent that the very existence of the state was put into question. The government failure became pervasive and much more visible than the market failure (Popov, 2000; Popov, 2004; Dutkiewicz, Popov, 2005).

In 1998, right before the currency crisis, the payment system was on the brink of collapse – barter deals exceeded 50% of total transactions and the enterprises were accumulating non-payments (trade, tax and wage arrears), delaying payments to their partners, the government and their workers indefinitely). After the economic growth resumed in October 1998, the non-payments and barter transaction quickly disappeared, but there is no guarantee that they could not rise again, if the monetary authorities will resort to tight monetary policy.

Tax collection, after dramatic fall in 1992-98, increased slightly, but mostly due to the resumption of growth, not due to better tax compliance. The efficiency of the government in recent years did not improve: different measures of corruption, government effectiveness and rule of law do not register any considerable progress, so low spending levels mean that the state simply cannot provide enough of the public goods.

But what is worse of all, the criminalization of the Russian society remains extremely high. Crime was rising gradually in the Soviet Union since the mid 1960s, but after the collapse of the USSR there was an unprecedented increase – in just several years in the early 1990s crime and murder rates doubled and reached one of the highest in the world[3]. By the mid 1990s the murder rate stood at over 30 people per 100,000 of inhabitants against 1-2 persons in Western and Eastern Europe, Canada, China, Japan, Mauritius and Israel. Only two countries in the world (not counting some war-torn collapsed states in developing countries, where there is no reliable statistics anyway) had higher murder rates – South Africa and Columbia, whereas in countries like Brazil or Mexico this

[3] Crime statistics is usually perceived to be incomparable in different countries because of large variations in the percentage of reported and registered crimes. But murders are registered quite accurately by both criminal statistics and death (demographic) statistics. The first one is more restrictive than the second one, since it registers only illegal murders, whereas the second one – all murders, including legal (capital punishment and "collateral damage" during wars, antiterrorist and other police operations). Both rates skyrocketed in Russia in the beginning of 1990s and stayed at the extremely high levels until today. The gap between both indicators widened during the first Chechen war (1994-96) and the second war (1999-2002).

rate is two times lower. Even the US murder rate, the highest in developed world – 6-7 people per 100,000 of inhabitants – paled in comparison with the Russian one.

When the murder rate reaches 40-50 people per 100,000 of inhabitants, like it did in Columbia in the 1990s, the country faces complete collapse of the state authority and basically degrades to chaos and warlordism. The unprecedented increase in crime rate in the 1990s, shocking murders of famous politicians, businessmen and journalists that went unpunished *de facto* bankrupted the law enforcing agencies and brought Russian state to the point of loosing its monopoly on violence.

The shadow economy, which the most generous of estimates place at 10-15% of the GDP under Brezhnev, grew to 50% of the GDP by the mid 1990s. In 1980-85, the Soviet Union was placed in the middle of a list of 54 countries rated according to their level of corruption, with a bureaucracy cleaner than that of Italy, Greece, Portugal, South Korea and practically all the developing countries. In 1996, after the establishment of a market economy and the victory of democracy, Russia came in 48th in the same 54-country list, between India and Venezuela.

Another good proxy for measuring institutional capacity of the state is the financial strength of the government - the share of state revenues in GDP. Though much have been said about "big government" and too high taxes in former socialist countries, by now it is rather obvious that the downsizing of the government that occurred in most CIS states during transition went too far. This argument has nothing to do with the long-term considerations of the optimal size of the government in transition economies – it is true that in most of them government revenues and expenditure as a share of GDP are still higher than in countries with comparable GDP per capita. But whatever the long term optimal level of government spending should be, the drastic reduction of such spending (by 50% and more in real terms) cannot lead to anything but institutional collapse.

In general, from all points of view, the dynamics of the government expenditure during transition seems to be by far the more important factor of successful transformation than the speed of reforms. Keeping the government big does not guarantee favorable dynamics of output, since government

spending has to be efficient as well. However, the sharp decline in government spending, especially for the "ordinary government"[4], is a sure recipe to ensure the collapse of institutions.

When real government expenditure falls by 50% and more - as it happened in most CIS and South-East Europe states in the short period of time, just in several years, - there are practically no chances to compensate the decrease in the volume of financing by the increased efficiency of institutions. As a result, the ability of the state to enforce contracts and property rights, to fight criminalization and to ensure law and order in general falls dramatically.

Thus, the story of the successes and failures of transition is not really the story of consistent shock therapy and inconsistent gradualism. The major plot of the post-socialist transformation "novel" is the preservation of strong institutions in some countries (very different in other respects – from Central Europe and Estonia to China, Uzbekistan and Belarus) and the collapse of these institutions in the other countries. At least 90% of this story is about the government failure (strength of state institutions), not about the market failure (liberalization).

Before transition in former socialist states not only government regulations were pervasive, but also the financial power of the state was roughly the same as in European countries (government revenues and expenditure amounted to about 50% of GDP). This allowed the state to provide the bulk of public goods and extensive social transfers. During transition tax revenues as a proportion of GDP decreased markedly in most countries. However, Central European countries and Estonia managed to arrest the decline, while Russia (together with Lithuania, Latvia, and several Southeast Europe and Central Asian states) experienced the greatest reduction. In Vietnam the share of government revenues in GDP grew by 1.5 times in 1989-93. Chinese government revenues as a percentage of GDP fell by over 2 times since the late 1970s, but it looks more like a conscious policy choice rather than a spontaneous process (authoritarian regimes have always better powers to collect tax revenues, if they choose to do so, as did all governments in the CPE's before the transition).

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[4] Expenditure for "ordinary government" – total government outlays, excluding defense, subsidies, investment and debt servicing (see Naughton, 1997).

In most CIS states the reduction of the government expenditure occurred in the worst possible way - it proceeded without any coherent plan and did not involve the reassessment of government commitments. Instead of shutting down completely some government programs and concentrating limited resources on the other with an aim to raise their efficiency, the government kept all programs half-alive, half-financed, and barely working.

This led to the slow decay of public education, health care, infrastructure, law and order institutions, fundamental R&D, etc. Virtually all services provided by the government - from collecting custom duties to regulating street traffic - became the symbol of notorious economic inefficiency. There were numerous cases of government failure which further undermined the credibility of the state since many government activities in providing public goods were slowly dyeing and were only partly replaced by private and semi-private businesses. Exceptions within CIS prove the rule: Uzbekistan and Belarus, i.e. exactly those countries that are not only known for proceeding with slow reforms, but are also believed to have the strongest state institutions among all CIS states.[5] Ukrainian example, on the other hand, proves that it is not the speed of reforms *per se* that really matters: being a procrastinator, it did nevertheless worse than expected due arguably to the poor institutional capabilities (trust in political institutions in Ukraine is markedly lower than in Belarus).

Institutional collapse was indeed the major reason for the extreme depth of the transformational recession (Popov, 2000; Popov, 2007; King and Treskow, 2004). The adverse supply shock in this case came from the inability of the state to perform its traditional functions. To reiterate, the institutional capacity of the state in this paper is understood in the broad sense - as the ability of the government to enforce rules and regulations. It includes its ability to collect taxes and to constraint the shadow economy, to ensure property and contract rights and law and order in general. Naturally, poor ability to enforce rules and regulations did not create business climate conducive to growth and resulted in the increased costs for companies.

Viewed in such a way, the institutional capacity of state appears to be stronger in autocracies (both – liberal and illiberal) and in liberal democracies, but weaker in *illiberal democracies* - countries

[5] The decline in government revenues as a % of GDP in these countries was less pronounced than elsewhere in CIS.

with poor tradition of the rule of law undergoing rapid democratization. In this sense early democratization in the poor-rule-of-law-states incurs high economic and social costs and is detrimental to growth, since it limits the ability to ensure property rights, contracts, reasonable business climate and order in general.

It is precisely this strong institutional framework that should be held responsible for both - for the success of gradual reforms in China and shock therapy in Vietnam, where strong authoritarian regimes were preserved and CPE institutions were not dismantled before new market institutions were created; and for the relative success of radical reforms in EE countries, especially in Central European countries, where strong democratic regimes and new market institutions emerged quickly. And it is precisely the collapse of strong state and institutions that started in the USSR in the late 1980s and continued in the successor states in the 1990s that explains the extreme length, if not the extreme depth of the FSU transformational recession.

To put it differently, Gorbachev reforms of 1985-91 failed not because they were gradual, but due to the weakening of the state institutional capacity leading to the inability of the government to control the flow of events. Similarly, Yeltsin reforms in Russia, as well as economic reforms in most other FSU states, were so costly not because of the shock therapy, but due to the collapse of the institutions needed to enforce law and order and carry out manageable transition.

The transformational recession was brought on not so much by the market liberalization, as by the virtual collapse of the state: countries that were successful in keeping government revenues and spending from plunging (Central Europe, Estonia, Uzbekistan and Belarus), the decline in production was less substantial. In contrast, in Russia and other FSU countries, apart from those mentioned above, spending on “ordinary government” (excluding spending on defence, investment and subsidies, and debt servicing) in real terms decreased three-fold and more, so that purely government functions – from collecting custom duties to law enforcement – were, to all intents and purposes, transferred to the private sector or were de facto “privatized.” The state capture index, which was calculated by the EBRD on the basis of polls of enterprises in the late 90’s and reflected the degree of subordination of government bodies to private interests, showed that Russia and the

other new CIS democracies were much worse off than the Central European democracies and even the authoritarian regimes of Uzbekistan and Belarus.

The most important achievement of the recent years is that the growth of the economy and the political stability finally brought about some improvement of social trends: the number of murders reached a peak in 2002 and fell in 2003-05; suicide rate decreased in 2001-05; mortality rate stopped growing in 2004; birth rate after reaching a 50-year minimum in 1999 started to grow, marriage rate increased, divorce rate fell. On the other hand, a nearly 50% increase in the crime rate in 2002-05 is most likely the sign of better registration of crimes. True, the improvements are very marginal, but at least there is a hope that was completely missing previously.

Growing economy with falling inflation by themselves cannot stop the disintegration of the society, if social inequality widens and the criminalisation increases; centralization and "construction of the vertical power structures" cannot stop the collapse of the state, if they do not lead to greater order and smaller shadow economy. As a matter of fact, the major criticism of Putin in recent years was that his centralization of power does not lead to the improvement of social order. Now it seems like there are some signs of real, not superficial stabilization and restoration of the state capacity. As opinion polls show, the majority of Russians believe that the biggest national issue today is strengthening of law and order, not the protection of democracy and not the containment of authoritarian trends. In fact, most Russians would be willing to trade some democracy for greater law and order. Is such an exchange possible?

Strictly speaking, we still do not know. While there is good statistical evidence that democratization under the poor rule of law leads to the weakening of the state capacity (Polterovich, Popov, 2005), there is less evidence that the reverse movement (to authoritarianism) contributes to the strengthening of the institutions (there are too few observations). There is always a danger that authoritarian regimes would not have enough checks and balances preventing them from the misuse of power. One should choose among the least evils, however. The greatest danger that Russia faces today is the collapse of the state, disorder, chaos and the break down of the country. If centralization of power works (and it seems to be somewhat working in recent years), even at the expense of some democratic freedoms, there is a chance that this worst scenario (chaos) could be avoided.

Determinants of FDI

It is not easy to explain cross-country differences in FDI inflows. But there are obviously a number of factors that are known to influence FDI inflows. Among them are GDP per capita (the lower is the level of GDP per capita the higher is the inflow of FDI as a % of GDP of the recipient country), economic activity per unit of territory (GDP per 1 square km of territory), the effectiveness of the government, the level of tariff protection and the increase in this level (the higher the tariff, the greater the stimuli to invest in a country instead of exporting to this country from abroad)[6].

Interestingly enough, out of all the indicators of the institutional quality and political regime it is the effectiveness of the government that matters most. Other indicators, such as rule of law, investment climate index, corruption perception index, democracy indices (political rights index from Freedom House) are not statistically significant. To put it differently, foreign investors can live with authoritarian, corrupt and even lawless regimes, if the governments are relatively efficient in terms of their ability to enforce rules and regulations (even if they are arbitrary).

Russia in terms of attracting FDI, as compared to the other regions of the world and to other major countries, was obviously not very successful in recent 10-15 years – fig. 1, 2. Even though Russian legislation in recent years was very benevolent to FDI, and Russia is rich in resources (mostly oil and gas, where the bulk of FDI goes), the cumulative FDI inflows flows for 1989-2004 per capita were just about the lowest among EE and FSU countries - $50 only as compared to several thousand in Czech Republic, Hungary and Estonia (fig. 3).

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[6] The following regression incorporates all listed factors on the right hand side:

FDI =1.8 – .05***Ycap75*** + 33.3***Y99_AREA*** +.65***GovEff*** + ***ImDuties****(.002***Ycap7 5***–. 09) + .01***IDincr***
(N=46, Adjusted R^2 = 65%, all coefficients significant at 9% level or less), where
FDI – average annual inflow of FDI in 1980-99 as a % of GDP of the recipient country,
Ycap75 – PPP GDP per capita in 1975 as a % of the US level,
Y99_AREA – ratio to PPP GDP in 1999 in $ to the area of national territory in sq km,
GovEff – government effectiveness index, WB, 2000, ranges from –2.5 to +2.5, the higher the more effective is the government,
ImDuties – average import duties as a % of total import in 1980-99,
IDincr - average import duties as a fraction of import in 1980-99 as a % of 1971-80 level.

Fig. 1

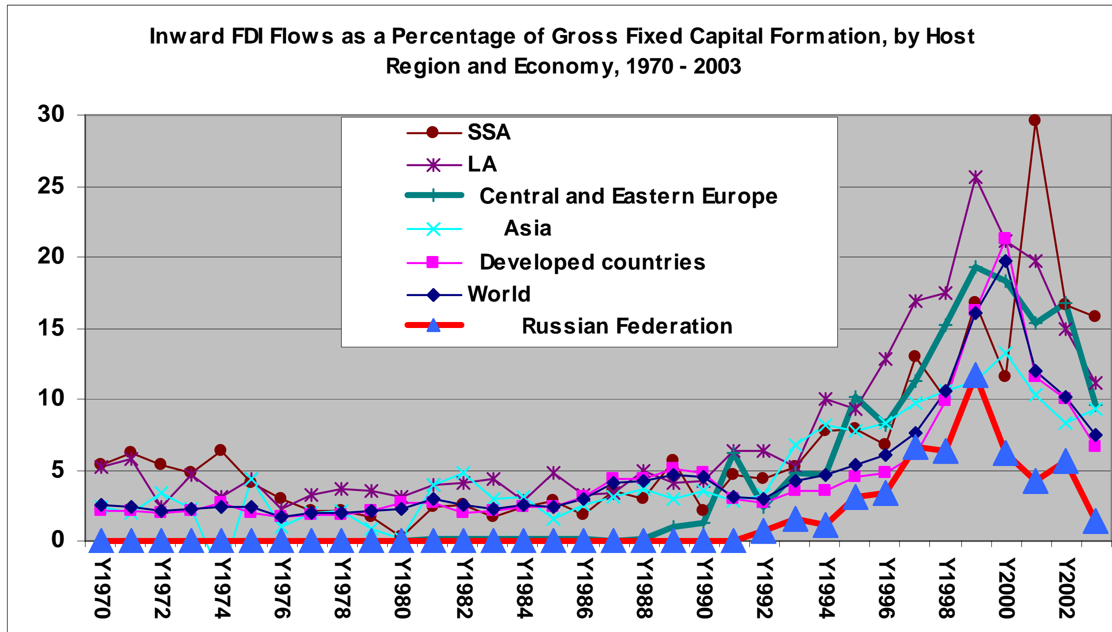
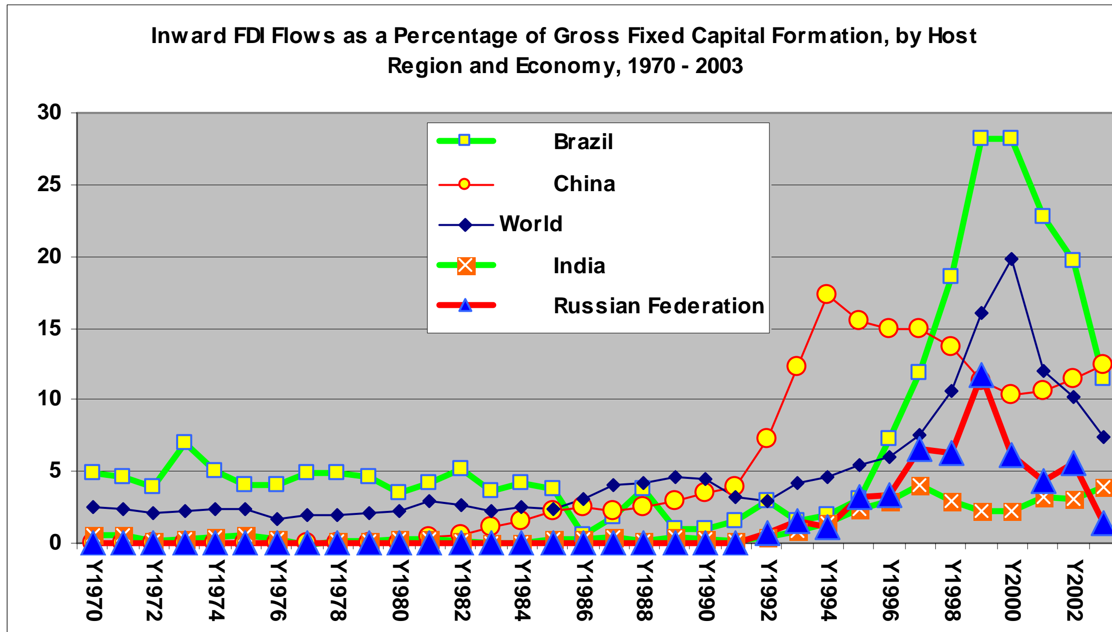
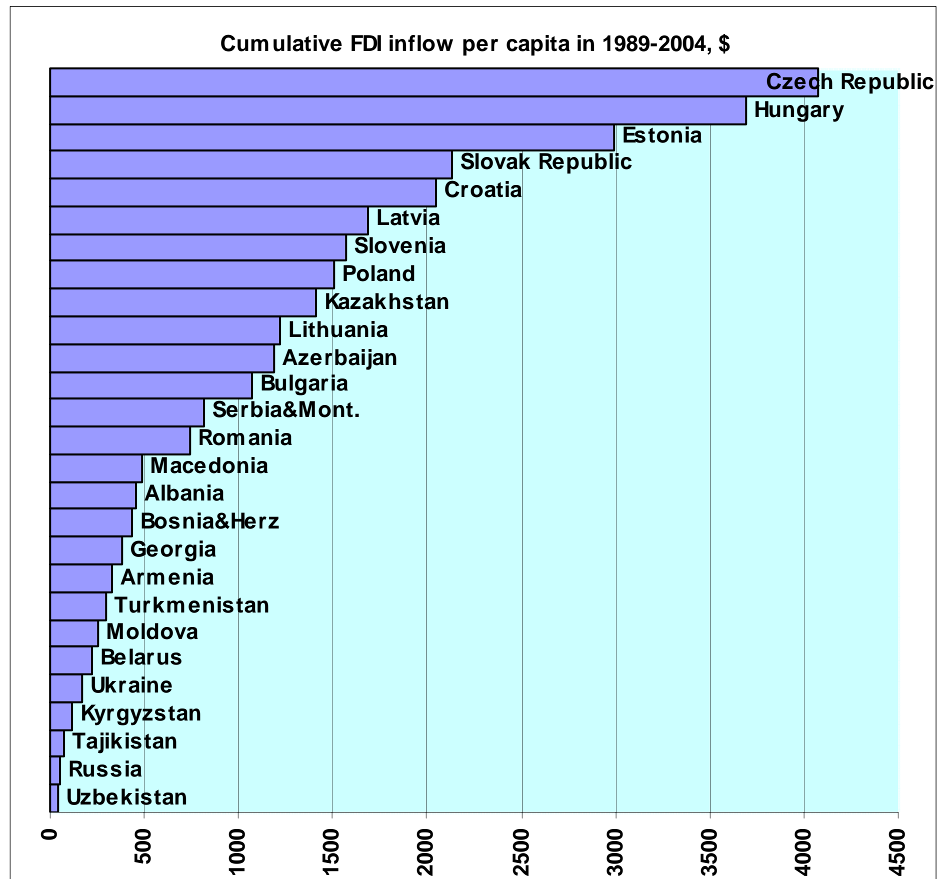


Fig. 2



Source: World Investment Report, UNCTAD, 2005.

Fig. 3

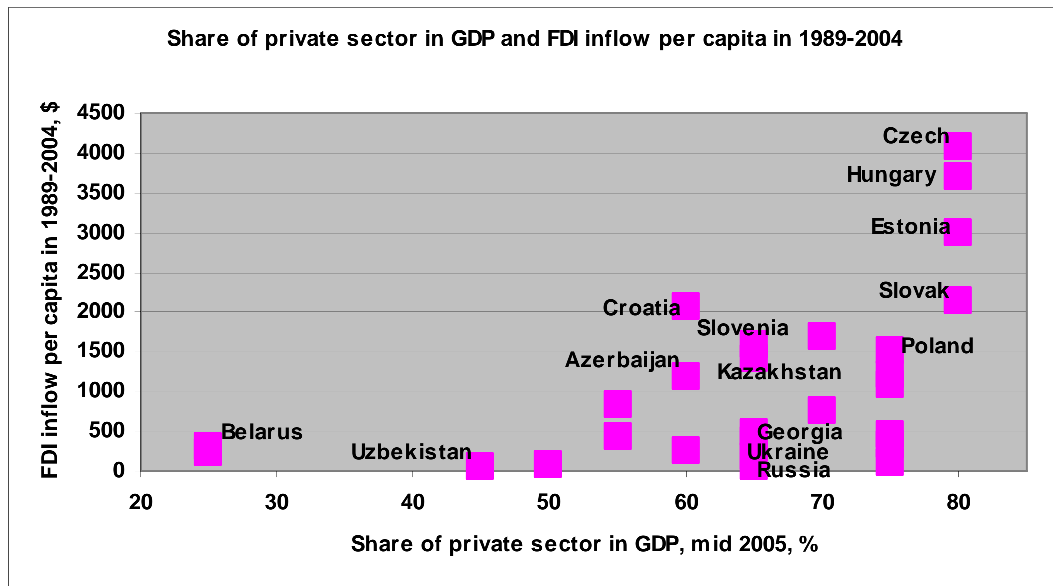


Source: EBRD Transition Report, 2005.

The comparison between Belarus, Russia and Ukraine is especially striking: Belarus without oil and gas reserves, without economic liberalization (only 25% of GDP is created at private enterprises as compared to 70% in Russia and Ukraine) and without democratization managed to attract 4 times more FDI per capita than Russia.

The natural hypothesis is that the government effectiveness in Russia is a negative factor that by far outweighs the attractions associated with the resource abundance, FDI-friendly legislation and relatively high level of economic liberalization. The latter factor appears to have some impact on the amount of incoming FDI (fig. 4), but only because it is quite correlated with the government effectiveness index. If both indices are included as explanatory variables, the impact of economic liberalization becomes statistically insignificant.

Fig. 4



Source: EBRD Transition Report 2005.

Impact of FDI on growth

The impact of FDI on growth is thought to be different from the impact of portfolio and short-term investment flows. There is no evidence that the free movement of short-term capital promotes economic growth (Stiglitz, 2000; Griffith-Jones, Montes, Nasution, 2001; Singh, 2002). Whereas the conventional wisdom before Asian 1997 currency crises recommended full liberalization of capital accounts, today's consensus, if any, leans towards the understanding that cost associated with free short-term capital flows (volatility) are too high, while benefits are not obvious (Montes, Popov, 1999). The IMF has admitted that forcing developing countries to open their markets to foreign investors could increase the risk of financial crises. "The process of capital account liberalization appears to have been accompanied in some cases by increased vulnerability to crises," the fund said in a report (Prasad et al. 2003) prepared by a group, including its then chief economist Kenneth Rogoff.

Whereas with respect to portfolio and especially to short term capital flows, the balance of costs and benefits is at best unclear, it is widely accepted that the inflows of FDI, that are not volatile and that often constitute the most efficient channel for the new technology transfers, are good for developing countries. True, fast growing developing countries experience the net inflow of foreign direct investment. However, there are important exceptions: more developed fast growing countries

(Japan, South Korea, Hong Kong, Norway) are net exporters of FDI. On the other hand, not all the countries that received large inflows of FDI demonstrated impressive performance: among just a dozen countries with the annual average inflow of FDI in 1980-99 of the magnitude over 2% of GDP are Bolivia (-0.2 annual average growth of GDP per capita in the same period), Papua New Guinea (0.3%) and Swaziland (1%).

The most persuasive example in this respect is probably that of China: it was growing at about 10% a year in the first decade of reforms, 1979-1989, when the country did not have virtually any FDI (accumulated stock by 1990 – about $10 billion), and continued to grow at the same rate afterwards, in 1991-2005, (cumulative inflows in this period totaled US$ 500 billion).

Cross country regression of growth rates in 1975-99 on the FDI inflows works only with few control variables[7]. If the other control variables are added (investment climate index or average share of investment to GDP in 1975-99), the impact of FDI on growth becomes negative and insignificant, whereas R^2 increases to 50%.

The same is true for the relationship between FDI and total domestic investment. As fig. 5 suggests, there is an obvious correlation between the share of FDI in GDP of the recipient country and the share of all investment in GDP for 1975-99 period. But there are important exceptions. On the one hand we find countries with relatively high share of FDI inflows in GDP, but with low investment/GDP ratios (Angola). On the other hand, there are countries with very high investment/GDP ratios without any net inflows of FDI (Korea, Samoa, Bhutan).

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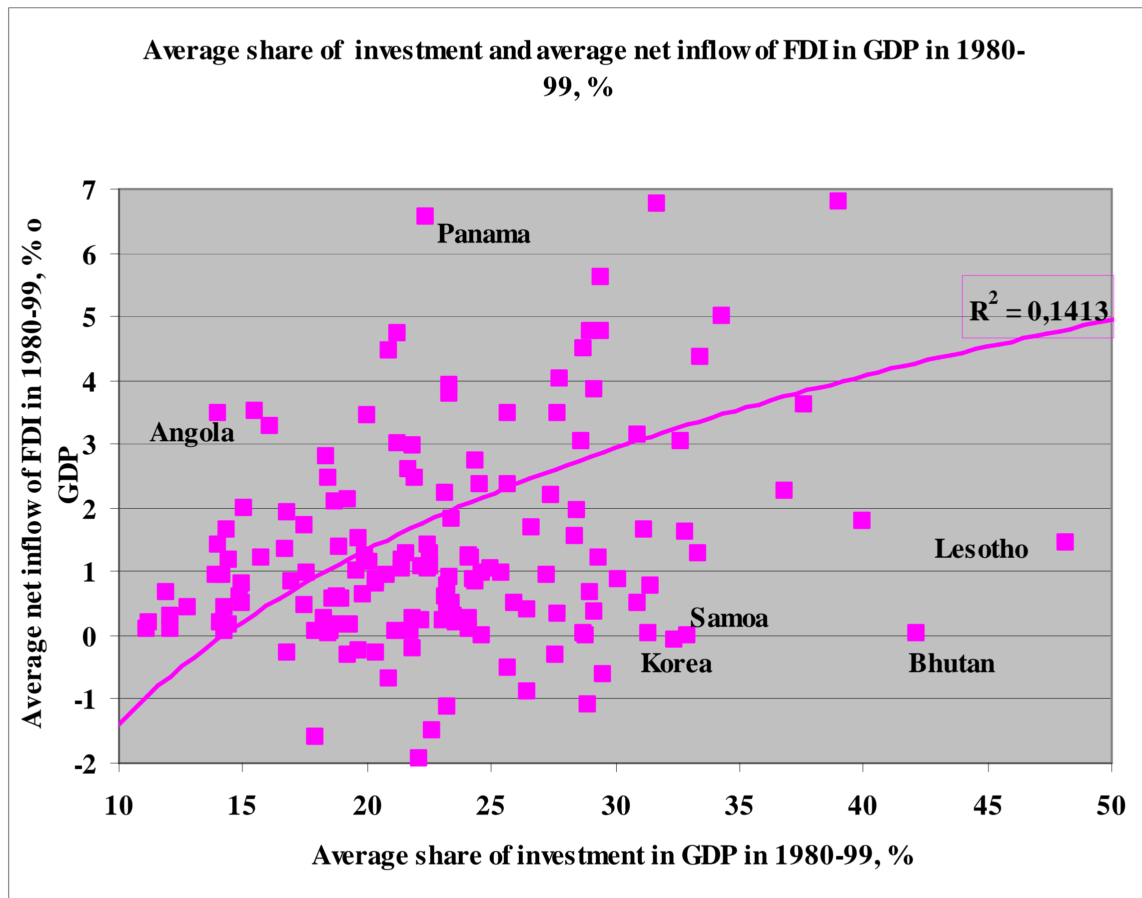
[7] $\boldsymbol{GROWTH} = a_0 + a_1\boldsymbol{POPgr} + a_2\boldsymbol{Ycap75} + a_3\boldsymbol{FDI}$
(N=54, Adjusted R^2= 17, all coefficients significant at 8% level or less), where

GROWTH – annual average growth rates of GDP per capita in 1975-99,
POPgr – annual average growth rates of population in 1975-99,
Ycap75 – GDP per capita in the beginning of the period, 1975,
FDI – annual average net inflow of FDI as a % of GDP of the recipient country in 1980-99.

Fig. 5



Source: World Development Indicators. World Bank, 2002.

It may be hypothesized that the FDI inflows into countries with poor investment climate do actually more harm than good. First, there is a self-selection of investors – if the investment climate is bad, foreign investors come mostly for short-term profit and/or resource projects, where the transfer of technology, the main benefit of FDI, is at best limited. Second, foreign investors do not reinvest profits in countries with poor investment climate, so the outflow of profits with time outweighs the inflow of FDI. Third, purchases of companies in countries with bad investment conditions do not necessarily lead to the increase in total investment because the inflow of FDI is often completely absorbed by an outflow of short term capital. There are other important considerations, of course, such as the ability of the country to absorb this investment – human capital, industrial infrastructure,

institutional capacity, etc. According to Nyatepe-Coo (1998), the productivity of FDI depends on the level of financial development and the degree of openness.

Regressions not reported here in detail (see: Polterovich, Popov, 2006) imply that FDI positively influence growth in countries with good investment climate and negatively – in countries with poor investment climate[8]. It is interesting that all equations give about the same and a very high threshold of investment climate index – about 80%, which is basically the level of developed countries. Only a few developing countries (Botswana, Hong Kong, Kuwait) have such a good investment climate. Similar regression also works with the government effectiveness index[9].

The threshold government effectiveness index – 1.3 – is very high, actually at a level of developed countries. Only a few developing countries, like Tunisia, higher or at par government effectiveness index.

Conclusions

The single most important factor limiting the inflow of FDI to Russia seems to be the inefficiency of the government – its inability to enforce rules and regulations. It is not the lack of the rule of law, or high corruption, or the insufficient democratization. Foreign investors are attracted to Russia by its natural resources, relatively high degree of economic liberalization, and favorable FDI legislation, but there are scared away by the poor institutional capacity of the state. There is also evidence that under such circumstances the benefits of FDI are quite weak and may be outweighed by cost (repatriation of profits, no transfer of technology). Building up institutional capacity and improving government efficiency should allow to kill two birds with one stone: attract more FDI and make sure this FDI is of high quality, i.e. conducive to economic growth.

[8] ***GROWTH*** = CONST. + CONTR. VAR. + ***FDI*** (0.02***ICI*** –1.61),
where ***ICI*** – investment climate index, ***FDI*** – average foreign direct investment inflow as a % of GDP in 1980-99.

[9] ***GROWTH*** = CONST. + CONTR. VAR. + ***FDI*** (0.33***GovEff*** – 0.42)
(N=45, Adjusted R^2 = 52, all coefficients significant at 5% level), where

control variables are ICRG investment climate index in 2000; 1975 PPP GDP per capita, population growth rates in 1975-99.

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