Foreign Capital Inflows of Resource-Rich Countries:

The role of governance infrastructure and exchange rate regime

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【Abstract】

Many studies have shown that natural-resource abundant economies tend to grow at a slower pace despite the potentially beneficial impact of natural resource wealth on economic prosperity (the “natural resource curse”). The recent boom in commodity prices has brought about the increase in foreign capital inflows into resource-rich countries, which might amplify the business cycle fluctuations.

This study investigates the determinants of the foreign capital flows into resource-rich countries, focusing on the effect of institutional quality as well as economic fundamentals. This paper shows that progress of democratization promotes the acceptance of FDI in resource-rich countries with a high income level but cause withdrawal of foreign companies in low-income resource-rich countries. This paper also shows that the prevalence of corruption facilitates FDI in low-income resource-rich countries while reduction of corruption brings about increased FDI in high-income resource-rich countries. The progress of democratization might result in reduced FDI if dictatorship administration allows more room for collusion with foreign-based companies, or if progress of democratization makes the checking system more complex to improve the transparency. Preferable investment environments have been proven to increase FDI although they have insignificant impacts on short-term loans.

As for the effect of foreign exchange regime, it is verified that countries allowing foreign exchange rate flexibility and those with parallel foreign exchange practices decrease FDI and receive more capital inflow aiming at capital gain from the appreciated currency. International commodity prices have been more influential for short-term loans rather than FDI, suggesting that resource-rich countries are susceptible to speculative capital inflows during the commodity price booms.