BI Norwegian Business School – Thesis

-The "Grabbing Hand" of Corruption and FDI-
A Norwegian Case study

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Campus:
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Programme:
Master of Science in Political Economy

Supervisor:
Professor Anne Welle-Strand

Student:
Julie Haugli
ID number: **0814321**

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Julie Haugli

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Abstract

The objective of this thesis has been to investigate to what extent there is a correlation between corruption and Foreign Direct Investments. Additionally, a case study on Norway and to what extent Norwegian Multi National Companies relate to investments in corrupt economies is added. As a general framework this thesis builds upon the "grabbing hand" theory of corruption (Shleifer and Vishny 1998). Assuming that all public officials are self-interested, corruption is an inevitable part of an economy unless regulations are put in place to ensure that corruption is illegal. When corruption is widespread in a country, most of the studies used in this thesis show that foreign investors are reluctant to invest. Thus, this thesis hypothesize that high levels of corruption makes investment unfavorable. To an extent this hypothesis is found to be accurate if corruption is treated as an isolated variable. However, if adding variables such as institutional quality, rule of law, political stability, and infrastructure the correlation goes from negative to insignificant in several of the studies presented. In the case of Norway, this is found to be corresponding. Thus, this thesis argues that, as an isolated variable corruption is unattractive for investors unless other variables making investments attractive are present.

Content

Abbreviations

CPI- Perceived Corruption Index

EEA - European Economic Area

EITI - Extractive Industries Transparency Initiative

FDI - Foreign Direct Investments

GC - The Global compact

GDP - Gross Domestic Product

GRECO - Group of States against Corruption

ICRG - International Country Risk Guide

NMFA - Norwegian Ministry of Foreign Affairs

MNCs - Multinational Corporations

NHO - Confederation of Norwegian Enterprises

OECD - Organization for Economic Cooperation and Development

TI - Transparency International

TNCs - Transnational Corporations

UNCAC - United Nations Conference Against Corruption

UNCTAD - United Nations Conference on Trade and Development

WB - World Bank

1. Introduction

In 2010, developing countries received almost half of all global foreign direct investments (FDI). By attracting FDI developing countries are able to achieve economic growth that under the right conditions may lead to economic development. Yet, the right conditions are seldom present in developing countries. A common denominator for both developing and transition economies are political systems where corruption and bribery is widespread (OECD 2002). Corruption is a multi-billion dollar "industry" which largely surpasses the overall global development aid transactions (ibid.). Corruption is also viewed as a "grabbing hand" which leads to increased costs both for potential investors and for the society. Investments in developing countries are believed to have several positive spillover effects beyond the returns from investments. Positive spillover decrease when investments are subject to corruption and bribery, and economic development is not necessarily the outcome of FDIs.

If we assume that all politicians and public officials are motivated by self-interests, corruption becomes inevitable in countries where regulations and sanctions against bribery are poor or not present. Regulations aimed at prohibiting corruption have gradually gained access to the laws of several countries, and anti-corruption efforts in the global markets have a larger part on the agenda. Despite such efforts multinational corporations (MNCs) from countries regarded as "clean" are still involved in corruption scandals. The combination of strict home-country legislation and increased negative attention on defaulting MNCs suggests that MNCs from countries abiding anti-corruption laws would be reluctant to invest in countries with pervasive corruption. Nonetheless, examples of the opposite are reoccurring. Loosing investments due to corruption is another cost on a society. If the uncertainty regarding amount of bribes required in order to gain market access is sufficiently high, the unknown costs of corruption might imply that the investment does not occur.

Norway is one of the countries ranked as "highly clean" in Transparency International Perceived Corruption Index (CPI). Norwegian companies have nevertheless been found just as likely to invest in corrupt countries as MNCs from generally more corrupt countries (Søreide 2004). However, anti-corruption work

has gained more acknowledgements during the last years, both in Norway and globally. A series of international and domestic initiatives aimed at targeting corrupt behavior in foreign investments have led to sanctions against corruption. Being caught in corruption can thus be extremely damaging to a company's reputation. During the last 20 years, bribery in foreign investments has gone from tax-deductible to strictly illegal in Norway (Benito 2010).

Widespread global ratification of anti-corruption law has lead to new manners of conducting investments. Host countries eager to attract investors sidestep corruption laws by facilitating corruption through start up fees, profit fees and local agents. Local agents who work as facilitators for foreign companies are perceived as a legal way of circumventing direct bribery and red tape in several countries with widespread corruption. The global markets are changing, FDI has rapidly increased during the last decades and more and more investments are directed to countries where governance is questioned.

The main objective of this thesis is to investigate whether corruption scares or attracts foreign investors, and which variables affects this correlation. The hypothesis depicted from the study of Mauro (1995) is that an increase or decrease in level of corruption in a country leads to an equivalent decrease or increase in FDI. Thus the hypothesis of this thesis is that; *FDI and Corruption is negatively correlated.* The research questions are,

1.To what extent is there a correlation between corruption and Foreign Direct Investments?
2. How does the correlation between corruption and FDI relate to Norwegian FDI?

Including the introductory part, this thesis consists of five main parts aimed at giving an in-depth assessment of the factors affecting the correlation between corruption and FDI, in addition to a case study on Norwegian outward FDI and corruption. Part two discusses the research design and methodology utilized as well as the central terms, limitations, assumptions and the theoretical framework that this thesis builds upon. Part three is a review of the literature and empirical findings on corruption, FDI and the research conducted on the general correlation between corruption and FDI. In part four research and reports on Norwegian

outward FDI and its connection to the global framework is examined. Part five is a discussion of the findings in the previous parts and its connection to the research questions. Lastly a section with concluding remarks will be presented.

1.2. Aim/ Motivation of the thesis

This thesis seeks to analyse the relationship between the amounts of FDI a country receives and the level of corruption in the host country. An earlier superficial study of the topic lead way to the belief that where perceived corruption is high FDI is low, further examination of the research question enabled a different understanding. Considering high corruption levels in many of the countries that receive extensive FDI, such as China, the discoveries were found to be contradictory. Given the increased attention Corporate Social Responsibility (CSR) has achieved during the last decade, both in Norway and globally, there is an augmented focus on ethical investments. From the governmental level, firms are recommended not to bribe or engage in corruption, and there seems to be consensus on the unprofitability of investing in corrupt areas. However, many multinational corporations (MNC's) are investing in countries that are ranked as highly corrupt.

Research emphasize that a high degree of corruption should be associated with a higher risk when investing, thus, there should be a negative relationship between the perceived level of corruption and the amount of FDI in countries worldwide. However, it seems as if the profitability of investing in certain countries is greater than the perceived costs of corruption. Consequently, several Norwegian companies invest in areas of interest regardless of the level of perceived corruption. Therefore, other circumstances in the potential country when investing is a key aspect when Norwegian companies invest abroad, although a country ranked as "highly unclean" may receive a great deal of FDI through facilitating a preferable business environment. Parallel to this the increased focus on CSR have led many Norwegian firms to commit to voluntary initiatives aimed at combatting corruption and increase transparency. This thesis will therefore particularly examine Norwegian firms investing abroad and Norwegian commitment to anti-corruption initiatives.

2. Methodology

2.1. Research design

The theoretical framework of this thesis is "the grabbing hand" theory of corruption. This theory is applied to the inflow of FDI in the literature review. The literature review consists of an analysis of findings in the empirical literature. Further a case study of Norway is applied to the qualitative analysis of the general correlation between corruption and FDI. The assessment of the literature is a causal analysis, where the effect of one variable, corruption, on a dependent variable, FDI, is analyzed (Della Porta & Keating 2008). A causal research design seeks to investigate empirical cases to test hypotheses (ibid). Further a Norwegian case study is added to this thesis as an example of a society considered highly ethical that has several large MNCs operating abroad. Adding an exploratory case study gives a further understanding of the causal analysis of the literature assessed in section 3. Thus the Norwegian case study offers an example of the concepts discussed in the literature review. This method is chosen because the empirical literature found and presented in the literature review, combined presents a thorough understanding of the correlation between corruption and FDI. After an attempt to recreate a cross-sectional analysis similar to those presented here, it was found that the scope of such a quantitative analysis would leave no room for a case study. A case study is believed to add a hands-on understanding of motivations in foreign investments. In the preliminary thesis report an introduction to the variables utilized in the recreation of the cross-sectional analysis can be found.

2.2. Research methodology

A variety of research methodologies can be applied to the research questions in this thesis. Due to the large scope and extensive literature on the topic this thesis is constructed on secondary and third party data. Common sources are quantitative analyses/ regressions of the correlation between corruption and FDI, where some value of FDI is the dependent variable and some value of corruption is the independent variable. Added are a variation of explanatory variables believed to have an impact of the correlation between corruption and FDI. Additionally a case

study on Norway is applied; section 2.2.2 gives an introduction to case study methodology.

2.2.1. How to interpret the results presented in the literature review?

These analyses show how an increase/decrease in the level of perceived corruption affects the dependent variable, namely FDI. By instance, one of the studies finds in a cross-sectional regression analysis that a 1 point decrease in the CPI index (perceived corruption) lead to an 11 % decrease in the amount of FDI inflow. A cross-sectional analysis does normally not take into account numerous years. It only shows the correlation in a given year, or at one point (Clausen & Eikemo 2012). Therefore this is not to be interpreted as if a country that is suddenly perceived as more corrupt would experience a decrease in FDI inflow of 11 %. It rather means that at that given time the average decline in FDI when declining 1 point on the CPI index (e.g Norway at 9 relative to Japan at 8) would lead to 11 % less FDI inflow. It is recognized that the result is not that straight forward, meaning that it is not directly applicable to country specific comparisons, as it is the general findings of a data set that contains numerous countries. Thus, it does not mean by instance, that because Japan scores one level poorer on the CPI index than Norway, Japan receives 11 % less FDI than Norway.

Given that cross-sectional analyses does not account for the time variables, that is changes over time, the studies presented in the literature are chosen because they apply both cross-sectional analysis and panel-data analysis to the research question. Through adding a panel-data regression the researcher is able to analyze the differences over time and thus create a larger picture (ibid.). Creating a panel data regression with sufficient variables to explain the larger picture of the correlation between corruption and FDI has been viewed as a too large scope to be included in this thesis. However the variation and number of extensive analysis that covers both cross-sectional and panel data analysis in the literature is believed to sufficiently answer the research question.

The research used in this thesis choose different measures of their variables, whilst some measure FDI as percentage of GDP per Capita, others measure FDI as net inflows of FDI per capita. Which means that the basis of the studies may differ, and the studies are conducted with the dissimilar variables. Thus presenting

the actual quantitative findings become less interesting than presenting the analysis of the findings. Whilst some of the variables are presented in indexes others are presented as values, thus interpreting and presenting the actual quantitative results of the empirical literature has not been included in this thesis. Nevertheless, the literature presented in this thesis is chosen because of its ability to apply both cross sectional and panel data regressions to the research question, which is believed to give a more accurate understanding of the correlation between corruption and FDI.

2.2.2. Case study Norway

This thesis presents a case study on Norway. It is elaborated that Norway is perhaps not the most generalizable case, due to its small size, wealth and extraordinary commitment to anti-corruption initiatives. Nevertheless the Norwegian case is generalizable considering neighboring countries, western European countries, OECD members, UN members and those countries with high scores on the CPI index. As Berg emphasize, "when case studies are properly undertaken, they should not only fit the specific individual, group, or event studied, but also generally provide understanding about similar individuals, group or events" (2009, 330). Thus, Norway is found to be an applicable case study considering the similarities it has with the groups mentioned above. It is also assumed that MNCs globally are facing several of the same challenges, which in turn make the Norwegian case even more generalizable.

There exist various definitions on case studies in the social sciences. A case study is commonly added in a thesis to make a generalization of one or several topics, groups, persons, countries or the like. Case studies can be defined as "a method involving systematically gathering of enough information about a particular person, social setting, event, or group to permit the researcher to effectively understand how the subject operates or functions" (Berg 2009, 317). In this thesis the second research question focuses solely on Norway and its relationship to the correlation between corruption and FDI. Whilst the literature review part focuses mainly on analysis of quantitative studies, the Norwegian case study is to a greater extent based on qualitative studies. The case study investigates several levels of

Norwegian legislation, norms and attitudes towards foreign investments and therefore falls under the embedded case study approach (ibid.).

This thesis will seek to firstly explain the general correlation of corruption and FDI utilizing secondary quantitative analysis. By combining this approach with an explanatory case study of the Norwegian conduct on corruption and Norwegian investments abroad the researcher gets a more comprehensive understanding of the topic.

2.3. Limitations and assumptions

Research on the correlation between FDI and corruption mostly uses the International Country Risk Guide (ICRG) index or TI's Perceived Corruption Index (CPI) as a measure of corruption. These indexes are based on perceived corruption and not actual corruption. Mauro (1995) argued that one of the main obstacles to finding reliable sources on the consequences and the causes of corruption was that corruption in itself was hard to quantify. Although the CPI have made corruption more quantifiable, it is still important to emphasize the ambiguity of such indexes. In particular the CPI has been criticized for being an unreliable index, it has been criticized for being incomplete in some countries and incorrect due to the reliability on third party sources (Francisco 2007). Additionally measuring corruption is difficult because corrupt behavior is most often hidden. However, much of the criticisms towards these indexes are posed from country-officials unsatisfied with the picture painted of their country in general and government in particular (ibid.). Wilhem (2006) checked the validity of the CPI Index and found it to be highly correlated with three other variables depicting corruption, namely black market activity, excessive regulation and Real Gross Domestic Product per Capita (RGDP/Capita). He also found that the CPI Index had the strongest correlation with RGDP/Capita (ibid.). Both the CPI and the ICRG are commonly used in research, often both are used as a measure of cross-reference. This is because these are the most comprehensive statistics on corruption levels globally today and although there are certain limitations to their validity they still are believed to paint a general picture of the corruption levels in most countries.

Defining corruption is as well a challenge; most studies and indexes focus on

corruption by public officials. This thesis recognizes that corrupt societies are characterized by corruption by public officials, private persons and firms. As well the UNCAC does not distinguish between public and private corruption (Hechler 2010). Therefore, this thesis does not discriminate between corruption in the private and public spheres. The ICRG index covers all levels of risk in a society, political, economical and social. The CPI index ranks countries according to the extent of perceived public corruption and does not take into account corruption in the private sector. Nevertheless, this thesis assume that corruption in the private sector is correlated with corruption in the public sector, and that where public corruption is high it is likely that private corruption is equally widespread. Further given that most empirical literature on the correlation between corruption and FDI uses a combination of the ICRG index and the CPI, it is assumed that the empirical literature considers both private and public sector corruption. Thus, in the literature review it is also included a section discussing the informal sector and the dominance it may have in a society.

Whether rising levels of corruption in a country will affect foreign investments that are already present in a country, will not be discussed in this thesis, although this is relevant regarding the agglomeration effect that will be discussed later on. The main objective of this thesis is to see whether foreign investors deliberately avoid investing in countries with high levels of corruption, and to what extent companies from Norway invest in countries with high levels of corruption and how their anti-corruption commitment affects this relationship. Due to the lack of empirical studies on the correlation between corruption and Norwegian MNC's in FDI, the case does not have the same clear implications as found in the general limitations. There is however one qualitative study that is thoroughly discussed in the case study. Albeit, this study does not draw the same lines that we find in the general correlation. In the study corruption in foreign investments is treated as an isolated variable and say little about other variables affecting the allocation of an investment. Therefore research on Norwegian companies and foreign investments, excluding corruption is added, as well as research and reports on corruption from the Norwegian point of view.

2.3.1. Reverse causation

In a study where the research question investigates the correlation between two or more variables it is relevant to discuss the aspect of reverse causality. Causality is when the cause effect relationship between two variables is clear, meaning that one variable is found to be a consequence of the other (Berg 2009). Reverse causality implies that the cause effect relationship between two variables are unclear, in this case we assume that increasing levels of corruption leads to decreasing levels of FDI (ibid.). Reverse causality in this case would mean that less FDI leads to more corruption, or that a country, which receives a lot of FDI, becomes less corrupt. However, due to the fact that FDI is a relatively novel phenomenon and gradually increases, it is reason to believe that the reverse causality problem is not sufficiently present in this correlation to be dealt much weight. It is not clear whether the presence of foreign investors leads to less corruption or whether countries with heavy influence from foreign investors are perceived less corrupt than others, although an interesting question it will not be dealt much weight with in this thesis. Agglomeration effect, meaning that countries that already have high levels of foreign investments receive more foreign investments will be dealt with in some of the sections. The main objective of this thesis is to investigate whether corruption scares or draws foreign investors.

In the following literature review and discussion it is highlighted that corruption is not an exogenous variable unaffected by other societal and economical variables, neither is the link between corruption and FDI unambiguous. Nor does corruption in itself stand as the only obstacle for a foreign investment. All these aspects will be thoroughly discussed in the following sections.

The empirical literature presented in this thesis has certain limitations regarding the applicability to the research question. Although many of the studies used in the literature review investigates the correlation between corruption and FDI, there is no consensus on which additional variables may affect perceived corruption or scare-off investors. There are thus several potential pitfalls in generalizing the findings or assuming that there is a connection. Additionally some of the studies have limited time frames, uses evidence from limited areas or from economies in transition periods. However, all the studies investigate the

correlation between corruption and FDI regardless of the variables they find to affect the correlation, and combined they present a general understanding of the correlation and the affecting variables.

2.4. Central terms

In this thesis a variety of terms and abbreviations are commonly used. Some of these terms are terms of which the meaning and applicability is often contested. Thus, it is therefore useful to elaborate the common explanations of the terms, the potential pitfalls in their utilization, and how the term is referred to in this thesis. It is recognized that all these terms are ambiguous and that the authors of the literature used in this thesis may have had another understanding of the terms than how they are used here. Additionally a short explanation of the Transparency International (TI) Corruption Perceived Index (CPI) and the International Country Risk Guide (ICRG) index is included.

Corruption - is normally defined as the "the misuse of public office for private gain" (World Bank 2012). However, due to the controversy considering the term, corruption will be discussed more in depth in the literature review. Sources in this thesis commonly refer to corruption as corruption by public officials. The confederation of Norwegian Enterprises (NHO) defines that corruption is when "someone who is in a position of trust, private or public, abuses the responsibility and obligation associated with the position, and thus obtain a private benefit or reward. Both the giver and the recipient of such benefit or reward is corrupt" (2012). Although some of the studies used in this thesis separate between private and public corruption, due to reasons previously explained this thesis would not. Moreover this thesis acknowledges that the investor as the counterpart could just as likely initiate corruption and bribery.

Corporate Social Responsibility (CSR) – is a complicated term to define, this is because it commonly refers to a series of variables related to a corporations business, this could be within the core business of the firm or external "responsibility". However, it often refers to the extent of which a firm takes into account the social and economic impact of their business (Vogel 2005). Additionally the term is often used to describe extraordinary commitment by

firms through charity and voluntary initiatives to improve living conditions and contribute to a sustainable environmental impact. Hence, CSR is any initiative and practice by a company that goes beyond law requirements (ibid.). In this thesis the concept of CSR will not be discussed in depth. However, relating to the Norwegian case, many firms are concerned with keeping a socially responsible profile outwards. This profile may include having a strong attitude against corruption, hence, the need to define the concept of CSR (Also see: Triple Bottom Line).

Economic development – refers to changes and additions to societal and economic policies that affect inhabitants in a positive way (World Bank 2012). This could be through increased human capital, access to advanced technology, better living standards, better infrastructure, access to the global market and more competitive domestic production (Sen1999). Hence, economic development is viewed as positive development for the inhabitants of a country, although not a prerequisite. Economic development should not be mixed with economic growth (ibid.). This thesis refers to economic development as a positive outcome of sound structured economies, it also assumes that corruption is harmful for economic development.

Economic growth – is the growth in a country's Gross Domestic Product (GDP) and refers to increase in relative capital holdings of a country (The World Bank (a) 2012). Economic growth does not necessarily mean economic development, although economic development often is a byproduct of economic growth (Brinkman 1995). Several countries have experienced economic growth without increased living standards for the general inhabitant. Meaning that an economy may experience economic growth although corruption is widespread.

Facilitation payments- Facilitation payments are often used as a synonym to corruption and bribery. A more in depth analysis of the term, however, shows that facilitation payments is an accurate term used to describe entry costs and payments related to start-up fees, profit fees and payment of local agents abroad (OECD 1997). In this thesis the term is used to describe legal payments that a second- or third party actor further can use for bribery and corruption on behalf of others.

Foreign Direct Investments (FDI) – "Foreign direct investment are the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. 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 World Bank (b) 2012). In this thesis a wide definition of FDI is used, this means all larger investments from one country to another is included. This is a means of including all FDI, even though some of the empirical literature utilized here may define FDI as an amount over a certain threshold. In section 4 concerning Norwegian MNCs FDI, unless otherwise specified, is outward FDI.

International Country Risk Guide (ICRG)- is a monthly risk assessment of 140 countries worldwide carried out by the Political Risk Service Group (PRS Group 2012). It is a tool measuring the political, economical and financial risks within an economy, and is thus a common second source found in literature on the correlation between corruption and FDI. They assess these risks based on 22 variables, including corruption. Political risk is a rate of 100 points, economic risks 50 points and financials risks 50 points, adding the ratings on these variables each country gets its own risk profile. The index is not accessible and thus not available to everyone. (See table 1 on next page)

Table 1. Political Risk Components of the ICRG Index

POLITICAL RISK COMPONENTS

Sequence	Component	Points (max.)
A	Government Stability	12
B	Socioeconomic Conditions	12
C	Investment Profile	12
D	Internal Conflict	12
E	External Conflict	12
F	Corruption	6
G	Military in Politics	6
H	Religious Tensions	6
I	Law and Order	6
J	Ethnic Tensions	6
K	Democratic Accountability	6
L	Bureaucracy Quality	4
Total		100

Source:
PRS Group, International Country Risk Guide
http://www.prsgroup.com/ICRG_Methodology.aspx

As we see in table 1., the components of political risks in the ICRG index are several and corruption is only 6 out of 100 points of political risk. Each component is assessed individually and thus the corruption ratings become an isolated index where the value 6 is "highly clean" and 0 is "highly unclean". This is similar to the CPI index and country scores between the two are often compared and most often found to correspond.

Perceived Corruption Index/Corruption Perceived Index (CPI) – Initially presented in 1995 by Transparency International, the CPI index is a recognized index rating levels of perceived corruption in 183 countries worldwide (TI 2011). Since corruption is recognized as hard to measure perception of corruption is considered to be the most reliable source (Wilhelm 2006). It is based on a combination of polls from several large institutions, the World Bank, the Development Bank, regional development banks and Economists Intelligence Unit, amongst others. For a country to be included it must have been assessed by at least three of these organizations (TI 2011). On a scale from 0 to 10 the countries in subject are rated according to it's perceived corruption, where 10 is

highly clean and 0 is highly unclean. In 2011 New Zealand was perceived as the "cleanest" country in the world scoring 9,5 whilst there was a tie between Somalia and North Korea being most "unclean" country scoring 1. The index targets corruption by public officials, but the working definition of corruption used by TI do not differ between public and private corruption.

Triple Bottom Line (3BL) – The triple bottom line is a theory introduced by John Elkington in 1998 in his book, *Cannibals with forks: the triple bottom line of the 21st century*. The term refers to extending the bottom line of business and involves adding sustainability targets to the usual bottom line. Instead of focusing merely on *Profits*, Elkington (1999) introduced *People* and *Planet* as two important bottom line components. Planet means environmental impact of the business and people refers to the impact business has on societies, including labor rights, political regimes (ibid.). In this thesis the term triple bottom line is utilized to map the incentives of investors.

The terms presented above are, in this thesis, used in the context described above. This is due to the applicability of the understanding of the terms in the literature, and how these terms are commonly referred to speaking of corruption and its impact on FDI. There is no universal understanding of these terms, neither in general, nor in the empirical literature. Thus, these explanations are generalizations of how these terms are commonly used. As a simplification this thesis use the terms donor- and host country, when explaining FDI. These are terms commonly used regarding aid receiving countries and refer to givers and receivers of aid. In this thesis the term are used to describe "givers" and "receivers" of FDI.

2.5. Theoretical framework: corruption as a "grabbing hand."

Literature related to corruption often mentions the costs of corruption. This thesis assumes that corruption is perceived as costly when conducting transactions. Shleifer and Vishny (1998) argue that politicians do not seek office in order to maximize social welfare; instead their main incentive is to pursue their own selfish objectives, which in most cases mean money and power. Thus they argue that the "helping hand" theory and the "invisible hand" hand do not take into account the politicization of governments (ibid.). Opposed to these theories the

"grabbing hand" theory of governments, emphasize that corruption is costly due to two reasons.

Firstly, where central governments are weak all governmental agencies can demand bribes by private agents to conduct any transaction. Thus, insufficient institutional quality would always result in corrupt officials. Unless there exists a well-functioning legal system and regulations, "the grabbing hand" of corruption will be present. And where "the grabbing hand" of corruption is present, Shleifer and Vishny (1998) argue that, investments are unprofitable. Bribing each public official becomes too costly for the investment to be profitable, which is what happened in Russia during the post-soviet years. This then results in no foreign investments. Given that these officials generally have their own self-interest in mind, regulatory agencies will always have corrupt officials.

Secondly, due to the secrecy of corruption, investments become directed towards areas where the possibility to demand bribes is greatest. Examples of these investments are infrastructure and defense rather than education and health (ibid.). Thus, according to the "grabbing hand" theory of corruption investments are costly because excessive bribery leads to less investments, and because the secrecy of corruption leads to investments in "potentially useless projects". They also argue that secrecy of corruption leads to distorted markets where some gain monopoly positions, entry is difficult and innovation is discouraged. Thus there is little incentive for economic development and growth. The opposite of secrecy is openness and transparency. Shleifer and Vishny (1998) argue that the way to target the "grabbing hand" of corruption is through increased openness and transparency. Additionally they argue that increased economic and political competition can decrease level of corruption in a country.

In the aftermath of Shleifer and Vishny's study corruption is often been referred to as the "grabbing-hand" in political economy, meaning that corruption is a cost to all layers of a society, both economically and socially, with extra weight put on the economic impacts of corruption. During the 1990's the impact of corruption on economic growth and economic development was a new field of interest. Shleifer and Vishny (1998), Bliss and di Telia (1997) emphasize the increased costs corruption has on the economy, and all transactions carried out in a market. If we follow the reasoning of the "grabbing-hand" theory of corruption, we might

state that it is reason to believe that corruption would increase the costs for foreign investors, just as it does to domestic investors. This would reduce the profitability of investment projects, and hence discourage FDI.

3. Literature review

3.1. What is corruption, and what are its impacts?

During the last decades corruption has been considered one of the greatest hinders to achieve economic growth, accountability and democracy in developing countries. According to Transparency International (2012), corruption is omnipresent; in every country in every industry there exist examples of corruption. No country has a perfect score on the Corruption Perception Index (CPI), meaning that all countries have corruption to some extent. Nevertheless, some nations are perceived as more corrupt than others. Corruption isolated is expected to correlate with black market activities, red tape and overly extensive market regulation (Wilhelm 2006). However, the studies presented in this thesis do not consider corruption as an exogenous variable and institutional quality, infrastructure, political stability, employment rates, bureaucratization and literacy rates are some of the factors considered to affect allocation of FDI. Sandholt and Koetzle (2000) argue that corruption undermine the main aspects of democracy, emphasizing especially that corruption deter the concept of equal opportunity for everyone. Through bribes and "under the table" transactions government officials are able to discriminate between people. Politics, the police force and other high profiled occupations are chosen as an incentive to extract rents, which again discourages trust in public officials (ibid.). Through bribes firms and investors receive police protection, easy access to permits and licenses, speedy transaction processes and easy market access (Al-Sadig 2009). Defining corruption is as well difficult considering that regions and countries differ in their customs and norms on what corruption is and what is considered normal procedures.

Public officials can acquire their position through bribes and rents, which creates distortions in the political business cycles. Al-Sadig claims that; "corruption is an "arrangement" that involves "a private exchange between two parties (the 'demander' and the 'supplier'), which (1) has an influence on the allocation of

resources either immediately or in the future, and (2) involves the use or abuse of public or collective responsibility for private ends"(2009: 268)[1]. Corruption enables public officials to get monopoly positions. According to Transparency International corruption leads to inefficient and undemocratic political systems, where citizens are treated unfairly and monetary as well as fiscal policies are subject to exploitation (TI 2012). This was as well emphasized by Pinto and Zu who claim that "The economic environment- characterized as the degree of diversification of the economy, the degree of market competition, and the potential to extract rents- affects the incentives faced by government officials and investors to demand and pay bribes respectively. Hence corruption should be positively associated with opportunities to create and extract rents" (2008, 3). In the political economy framework corruption leads to efficiency losses where in the long-term norms and regulations created to facilitate more corruptive behavior may occur (Al-Marhubi 2006). These are views found in most literature and organizational reports on corruption. However, the opposite view does exist; corruption may "grease the wheels" in transactions. Corruption may thus lead to economic growth. Nevertheless, there seem as if there is a consensus on corruption deterring economic development through skewing distribution of benefits and thus works as a "grabbing hand".

3.1.1. Corruption and the informal sector

Developing countries with a high degree of corruption are often characterized by a great informal sector. With informal sector it's meant transactions that are conducted without formal recognition from the government or, "… the informal sector or shadow economy usually refers to economic activity that is not illegal *per se* but carried out at least partly below the radar of official statistics and regulations" (Huber and Boehm 2009: 48). In Asia the informal sector accounts for one third of GDP, and in Africa and Latin America, at large, as much as 40 %

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[1] Some of the sources and citations used in this thesis have previously been used in academic papers by the same author; "Corruption and FDI," Term paper in Development Studies: Trade, Aid and Microfinance 2010. "Inflation, Seigniorage and Corruption," Term Paper in Political Economy and Macroeconomics 2011. "The role of corruption and oil exports in attracting FDI," In collaboration with Mona Løvstad Tranøy, Term Paper in Public Opinion and Input Politics 2011. All of the papers above are written in the MSc program Political Economy at BI Oslo.

of GDP. In some countries like Azerbaijan, Nigeria and Tanzania the informal sector accounts for as much as 50% of GDP (ibid.). Still, a large informal sector is not necessarily considered a bad thing. The informal sector may carry out vital functions in the society, creating jobs and organizing otherwise unattended tasks. Nevertheless, when the economy to a large extent is characterized by a large informal sector, it becomes challenging not to engage with informal business partners when investing and contracting. In some countries the informal sector may be of such power that governmental restrictions and regulations may not affect them (Huber and Boehm 2009). Thus investing in a country with a great informal sector may imply dealing with a combination of regulated and informal contracts.

For the governments in charge, large informal sectors pose a challenge toward implementing regulations that would be profitable in attracting foreign investors. Such regulations are frequently referred to as "red tape", or excessive bureaucratization, and often have the opposite effect leading to more "under the table business" (Huber and Boehm 2009). When governments impose taxes and mandatory regulations in areas of the economy that previously has been exempted from regulations, a common outcome is that this sector goes even deeper underground (The World Bank Group 2012). Abiding new regulations are perceived as extensive costs where business opportunities may diminish through new regulations. Thus many developing countries find that acknowledging and maintaining the informal sector may actually lead to less corruption, than working against it (ibid.). Hence, international investors often find themselves involved with the informal sector when contracting abroad. Additionally, government officials may be more prone to behave corruptly in countries with a large informal sector, where bribing of government officials are considered more normal. This all ends in a downward ending spiral where politicians or government officials seek powerful positions in order to obtain bribes, that is, rent-seeking. Huber and Boehm (2009) emphasize that reducing red tape is one of the easiest ways of decreasing the extent of the informal sector. Widespread corruption may create a large informal sector, whilst a large informal sector may make corruption more legit. Thus, corruption and the informal sector are affecting each other.

3.*2. Global FDI*

Global FDI has increased at an exhilarating level during the last decades. Inter-border mergers and acquisitions are more and more common leading to more cross-border investments. Although most FDI is conducted in neighboring countries, large MNCs are expanding their business day by day. More developed infrastructure and high technology enables greater involvement in the global markets. Economies not attracting FDI are falling behind, leading to lack of economic- growth and development. In most developing countries FDI is considered the utmost tool to create prosperous economic development. According to Transparency International (2009) global FDI was at its greatest in 2007 with 1,8 trillion US dollars, with more than 500 billion US dollars to developing countries and 13 billion US dollars to the least developed countries. Of these, Africa and Latin America mostly experienced inflows targeted at resource extractions (ibid.). Global FDI has gradually been deregulated over the last decades, resulting in a FDI boom.

Likewise, the numbers of MNC's have expanded to 79,000, with over 80 million employees and generating 11% of global GDP (TI 2009). A large share of FDI is related to the increased need for resources, manufacturing and commodities that are outsourced due to low availability or too high production costs in the home countries. During the last decades there have been an extensive increase in private FDI to development countries. However the impact has been relatively skewed, some countries have experienced great economic development due to FDI inflows, other have been marginalized. Africa receives today only three per cent of Global FDI, mostly in the oil and gas industry. The least developed countries received in 2005 only 2 % of the global FDI. Norwegian FDI is only a very small percentage of total FDI in development countries (NMFA 2012). Most of the Norwegian investments in developing countries are within oil, gas, shipping and environment industries.

3.2.1. Why is FDI important?

Through FDI, companies from more developed countries may affect less developed areas in a positive manner, this may be through increased revenue,

creation of employment, knowledge spill-over and good corporate governance. Nevertheless, the dilemma arises when these companies invest in countries where governance is weak and investment opportunities are based on bribery and lack of control from governmental institutions. Contrary to exports/imports FDI is a long-term investment that is believed to have a certain influence on a society (Fløysand et. al. 2005). Such an influence could be both positive and negative. Revenue from investments may fall into the wrong hands, and FDI may be subject to the "grabbing hand", meaning that revenue that could have benefited a society as a whole may be subject to corruption.

Furthermore companies investing in corrupt countries have been accused of supporting corrupt governments and to take advantage of underprivileged and poor citizens with poor civil rights (TI 2009). Thus, critics argue that there are several sides to the investment game that should be handled through more transparency, more corporate social responsibility and a higher degree of regime knowledge. Although more corruption may lead to less FDI, TI emphasize that this does not necessarily mean that FDI promotes good governance and leads to less corruption (ibid.). "Corruption not only reduces FDI inflows but attracts lower quality investment in terms of governance standards" (Hellman et. al. 2002). It is argued that where governance is weak or lacking, an international investment may in fact increase the problem. In more developed countries, on the other hand, FDI seem to have a greater impact on both employees, and good governance (Wei 2000). This again may be a consequence of the correlation between weak governance and unequal distribution of goods and benefit in the country in question.

Many developing countries have large informal sectors with a great amount of bribery in business transactions. In some instances companies find themself excused from following "home rules" in order to generate revenue abroad. At the same time governments in countries with great informal sectors find it hard to tax certain industries, fearing that this may lead to unprofitable but legal companies. Such "weak governance" zones are particularly found in sub-Saharan Africa (Huber and Boehm 2009). Weak governance and weak institutions may lead to poorer corporate responsibility. Where governance is weak, we often find poor institutions with no, or little, property rights and poor regulations.

A developing country receiving a great extent of FDI is considered more likely to achieve economic development than one who does not. Additionally, countries receiving FDI is more likely to receive even more FDI, known as the agglomeration effect (Al-sadig 2006, Fløysand et. al. 2005). This is based on the belief that FDI from more developed countries is accompanied by the introduction of more advanced technology and higher efficiency, which again makes investments more tempting. Although domestic investors may have greater knowledge of the market, developing economies may be more interested in receiving investments from foreign investors and thus facilitates more for foreign investors than domestic investors (Borenstein et al. 1998). Recent development theory emphasizes the unique opportunity that may arise trough FDI.

Egger and Winner (2005) found that EFTA and the EU countries are those whose score on the TI CPI index shows the lowest perceived corruption, whilst Africa, South and Central America and the Asian economies are those who have the highest values of perceived corruption. These are often countries that have poor governance and poor infrastructure, thus the perceived risk associated with investments can be high. Globally, development and transition economies received 50,7 % of global FDI in 2011, of these China, Hong Kong, Russia and Brazil received 40 % (UNCTAD 2011). These are countries that scored poorly on the CPI. China scored 3,6 on the CPI in 2011. The high levels of FDI inflows to these countries are believed to be a combination of favorable markets, good infrastructure and governmental facilitation.

3.3. FDI and costs of corruption

Corruption is considered one of the main obstacles to economic development, simultaneously FDI is considered crucial to achieve economic development. With expanding global markets and increased global trade the global market actors are facing new dilemmas such as new investment climates where corruption is more apparent than in the home country. Customs and norms may differ as a whole, and what is illicit in one country may be a perfectly normal culture in another (Cuervo-Cazzura 2006). Future costs of corruption may be unclear as well. MNCs operating in corrupt economies may behave according to norms and general practice in the host country.

Consumers are more and more conscious on where and how the products they purchase are produced, and companies are more aware of creating an ethical and green profile to attract customers. In a survey conducted by TI in 2008, with MNCs from OECD countries more than a third of those questioned reckoned that corruption increases the cost of investing with more than 10 % (TI 2009). Whilst a smaller share believed that the costs were inflated to as much as a quarter (ibid.). Additionally future costs of corruption and bribery are often unclear. These findings are in line with the "grabbing hand" theory, and Mauro's (1995) findings that corruption leads to lower investments due to increased costs and unknown future costs. 45 % of the 390 senior business executives asked, stated that they had not invested in a certain country due to corruption (TI 2009). "Controlling for other factors that influence investment decisions, an increase in the corruption level from that of Singapore to Mexico has the same deterrent effect on foreign investment as a tax increase of more than twenty percentage points" (TI 2009; 59). Giving rise to the view that more corrupt countries attract less FDI. Likewise the analysis show that companies from more corrupt countries are often valuated lower.

Further it is argued that high-tech companies that are more protective towards their expertise are less likely to invest in corrupt countries, as they perceive the risk of leakage more perceivable when the environment is characterized by corruption, creating a downward going spiral where developing countries plagued by corruption misses out on much needed technology (TI 2009). Cases where ethics has been violated and the customers are aware of the unethical conditions of which the firm operates, are often viewed damaging to a companies reputation. Consumers are known to boycott companies that have behaved unethically.

A common approach to circumvent direct engagement in bribery is to have a local agent where procurement bribery is well hidden in fees to a mediator. Such local agents may help firms exempt anti-corruption law and further give them a comparative advantage where the local agents ensures faster and easier penetration of the market. In some cases and countries, firms are legally appointed a local agent, which does not necessarily imply that they get a greater comparative advantage. Rather this legal agreement is a way of creating extra revenue for governments or domestic firms exceeding the revenue from the contract (OECD

2012). Many perceive the latter as a form of legal corruption, and both international and local firms are accustomed to these types of extra costs. It is believed that the fees to these local agents are further delegated to bribing others in order to infiltrate the market. In these cases the "grabbing hand" becomes the helping hand. In the case study on Norway section 4.4.4. Further explains the concept of local agents and to what extent corruption by second-and third party agents is dealt with in the OECD convention and can be prosecuted by Norwegian legislation.

Governmental revenues are low when corruption is high which may lead to poor infrastructure, another element considered unattractive for foreign investors (Egger and Winner 2005). Thus, international investors operating in such areas find themselves paying extra to ensure that property rights and regulations protect their contracts. Several cases of bribery in less developed markets have prevailed during the last decades, and firms are aware of both the indirect and direct extra costs of corrupt behavior. Huber and Boehm (2009) emphasize the importance of committing to one of these initiatives, because failure of compliance leads to indirect costs to the company, which again makes non-compliance unprofitable. It is also believed that compliance with such initiatives may lead to greater profits, due to increased consumer awareness.

3.3.1. Anti-Corruption Initiatives

Increased consumer awareness as well as international focus on unethical firms has led to a series of initiatives aimed at making oversight more effective. Through the United Nations Global Compact (GC) firms voluntarily commit to act responsible in their operations, however, complying with the regulations of the GC is not legally binding and monitoring of the firms is difficult, and so is holding them accountable for defaulting. Therefore the GC has been criticized of being nothing more than CSR recommendation (Vogel 2005). The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions offers a set of guidelines for companies from OECD countries, and a few non-OECD countries, aimed at creating awareness on how to avoid corruption and bribery in business transactions (OECD 2012). In the oil and extractive industries EITI (Extractive Industries Transparency Initiative), focus at promoting more transparency in order to combat corruption in the extractive

industries.

Anti-corruption initiatives such as EITI work in a manner that connects host governments and the investing company to share their contract negotiations and combined revenue to the public, through this knowing that every move will be broadcasted. Nevertheless, Hayman (2009) argues that there are some crucial limitations to EITI considering that "It does not cover the allocation of oil and mining concessions, issues of money laundering or the tracking of revenues once they reach government budgets, to ensure that the money is spent properly" (2009; 56). Additionally he argues that voluntary initiatives such as EITI means that companies that join are often those who already have a clean sleeve (Hayman 2009). Restructuring of business in order to comply with voluntary initiatives is often perceived more costly than the extra costs of corruption. A further assessment of these initiatives is dealt with in section 4.3., on Norway.

Domestically it is not unusual to find organizations and institutions whose purpose is to spread knowledge on anti-corruptive measures. However, a survey conducted by TI in 2008 shows that most companies operating abroad are not familiar with the OECD convention (TI 2009). This survey also showed that in information and communication technology, pharmaceuticals, oil, gas, and mining and defense sectors less than 45 % of companies offers any sort of guidance on how to avoid engaging with corrupt partners. In Europe this percentage was slightly higher, where above 50 % of the firms offered this kind of training, whilst of firms originated in Asia and China only 10 % did the same (ibid.). Chinese FDI to development countries in general and Africa in particular have lead to questioning ethical investments.

With these statistics in mind, Transparency International argues that there are many international firms investing and operating in corrupt areas, which is problematic both considering the impact corruption is believed to have on development and business in general (TI 2009). Additionally whether a firm is committed to an initiative of any kind has little affect on its operations in real life, some of the initiatives mentioned above are voluntary and thus compliance is not legally binding or mandatory. Albeit, ratification of the OECD convention and the UNCAC has lead to widespread statutory sanctions against corruption. It is believed that agreeing to follow any of any voluntary initiative is normatively

binding and the costs of non-compliance is considered high and damaging to a companies reputation.

3.4. What does studies show on the link between corruption and FDI?

Mauro (1995) presented one of the first empirical studies on the relationship between corruption and FDI. Mauro's findings correspond with those of Shleifer & Vishny (1992), "rent extractions" or corruption is costly to a society. Shleifer & Vishny argued that this was especially true because where governance is weak bribing is more common, when all agencies needs to be bribed in order for a transaction to be followed through, investments rarely occur. Thus following the "grabbing hand" theory of corruption, Mauro (1995) found that corruption lowers economic growth. Investors are aware that all benefactions in the future may be subject to corruption, thus investments are not only subject to corruption at the present time they are also subject to rent extractions of profits in the future. Given that amount of bribes is not clear when entering a market, investors are not likely to invest. Investments increased by 5 % of GDP when corruption levels decreased by a one standard deviation from the index, consequently annual growth rate of GDP per capita increased by a half percentage point (Mauro 1995). Thus he argued that the effect corruption has on economic growth is directly correlated with investments. Which implies that investments as well as economic growth are dependent on the level of corruption in a country.

With the increasing focus on FDI and corruption as important variables affecting development in the poorer parts of the world, more researchers started to investigate the impact corruption had on FDI. Thus, there are several studies conducted on the correlation between corruption and FDI, mostly these studies have been conducted in the years after 2000. These empirical studies investigate the impact FDI has on corruption in a host country and further whether corruption determines allocation of investments. They also seek to investigate whether there are other important variables affecting the correlation. A common denominator for these studies is the hypotheses of "the grabbing hand" of corruption, meaning that corruption is most commonly perceived and hypothesized to be a cost for investors. It is commonly emphasized that if the country is a transition economy the impact of FDI on corruption could be positive. How FDI may affect host

countries with poor economy is often the motivation for these studies and it is stressed that if the economy is poorly developed FDI can lead to more corruption. However, stressing that FDI is important to achieve development it has been more popular to look into what determinants need to be in place for a country to attract FDI. One of these determinants is corruption and to what extent corruption "scares" investors.

Small variations in the purposes of the research means that the variables added differ, so does the outcomes. Al-Sadig (2009) argues that there is little consistency in the general empirical literature on the effect corruption has on FDI. However, it has been emphasized that there is a tendency in the literature towards finding a negative relationship. Hellman et al. (2002) as well emphasize this in a series of working papers for the World Bank. Wheeler and Mody (1992) were the first to link corruption to FDI inflows in developing countries and they found that American investors were more concerned about infrastructure and labor costs in a country were they decided to invest than the risk factors within an economy, including corruption, this they assumed to be generalizable to other investors (ibid.). Factors they rather found important were market size, growth of domestic economy and, and facilitation of contracting. These findings are similar to several of the studies presented in this thesis, where corruption is only one of many risk factors.

3.4.1. Negative correlation between FDI and Corruption

In line with the "grabbing hand" theory of corruption and the study of Mauro (1995), Smarzynska and Wei (2000) found a significant negative relationship between corruption and inflow of FDI. They claimed that corruption is an equally important determinant to composition of FDI as labor costs and corporate taxes, and thus should have more importance (ibid.). They argued that a firms mode of entry when investing in a host country is dependent on the level of corruption, having a local agent or partner may just be a way too circumvent direct bribes for a firm so that any direct bribery or corrupt behavior is avoided. Accordingly, when corruption reached a certain level, investments did not take place, however if corruption is lower firms will more likely do the investment but choose to have a local partner.

Where governmental transparency is low, long-term investments are viewed more risky due to unstable political environments, and so the opportunity to withdraw is deemed important. Thus, Smarzynska and Wei (2000) argued that corrupt developing countries are less likely to receive long-term international investments that can lead to development. When running the model Smarzynska and Wei (2000) found evidence that corruption led to less foreign investments, and they also found that the more technology based the investors were the less likely they were to use a local partner or any form for joint venture. This was in line with their hypothesis that firms who based their investment in high technology were reluctant to share important information with local partners in the host country (ibid.) There are however a great limitation to this study, they based their study on the findings on FDI inflows in eastern European and former Soviet Union countries in the years between 1990 and 1995. This means that the study contains a relatively small data set, and is dealing with the conditions at that time in the transition economies in Eastern Europe. Nevertheless this study shows a behavioral pattern of investors in transition economies. As well, we might assume that at this time there were generally high levels of corruption in the countries included in the study, similarly it is likely to believe that in the aftermath of the fall of the Soviet Union there were other variables making investments attractive lacking in these countries. As we saw from the Wheeler and Mody study (1992), investors are commonly attracted by infrastructure and labor costs when allocating foreign investments. And in this transition period in the former Soviet Union states there is reason to believe that the infrastructure for FDI was not yet put in place.

Some researchers argue that type of FDI is an important denominator to the impact of corruption. Brouthers et al. (2008) differs between two types of FDI, market-seeking FDI and resource-seeking FDI. In their study they found that the market-seeking FDI was less sensitive towards corruption, whilst resource-seeking FDI was more sensitive to level of corruption in the country they chose to invest in. This they state is because, resource-seeking FDI is based on investments aimed at cost-effectiveness relative to home-country costs (ibid.). Consequently, the perceived costs of corruption may exceed the potential benefits, scaring off investors. "Thus, for *resource- seeking* FDI we hypothesize that high market attractiveness cannot compensate for high corruption, and costs associated with

higher corruption have a negative impact on a country's level of *resource-seeking investment*" (Brouthers et al. 2008: 274). They found that countries with high levels of corruption that have attractive resources are less likely to receive investments due to the resource-seeking investors reluctance to invest in corrupt areas. FDI to development countries are mostly in the resource-seeking industries, thus according to Brouther et. al, developing countries with high levels of corruption are less likely to receive FDI.

More general research conducted by Al-Sadig (2009) and Egger and Winner (2005) initially supported the findings of Smarzynska and Wei (2000). The negative correlation was quite evident in the short run and affected FDI considerably. However, conducting the research in a long run perspective both found that the correlation became less negative. By adding variables related to favorable investment environments such as infrastructure, education and stable government they found that, in a long-term perspective, the negative correlation previously found became positive and/or insignificant. These studies will be further discussed in section 3.4.4.

3.4.2. Corruption as a stimulus for FDI

Positive correlation would mean that corruption leads to more FDI, or as Egger and Winner (2005) found; corruption can work as a stimulus for FDI. Which is one of the most contradictory studies to the hypothesis that a high level of corruption leads to less FDI. Egger and Winner (2005) argue that corruption enables faster bureaucratic decision-making, transactions and contracting. Through differentiating between "helping hand" and "grabbing hand", Egger and Winner explains how investors, in the short term, may be put-off by "the grabbing hand" of corruption. However, in the long run, corruption offers a "helping hand" which they find to foster FDI. This they find counterintuitive to previous assumptions that corruption is related to weak institutions and most investors will be reluctant to invest in areas with weak institutions.

On the other hand they argue that political risk and FDI is negatively correlated, when political risk increases, FDI decrease. This is more in line with the empirical findings of Smarzysnka and Wei (2000), Al-Sadig (2009), Wheeler and Mody (2002) and Mauro (1995) who all found that political risk and corruption is positively correlated. Thus, Egger and Winner suggest that their empirical

findings show that FDI and corruption is positively correlated, whilst FDI and political risk are negatively correlated. Glass and Wu (2002) support the view that corruption may foster inward FDI. This positive correlation they state occurs when good regulations are present. Similar to Egger and Winner (2005) Al-Sadig (2009) emphasize that corruption may help "grease the wheels" for foreign investors. Nevertheless, he accentuates that the risk of being caught as well as the costs of being caught are important determinants for firms considering for MNCs (ibid.). In a society where the institutional quality is high the costs of being corrupt increases.

Although Egger and Winner (2005) find a positive correlation between corruption and FDI they state that previous empirical research mainly have studied the long term effects corruption has on FDI, and have found it to be negative. They, however, believe that previous research have neglected how perceived corruption is correlated with other institutional variables (ibid.). Such institutional variables can be hard to measure and thus the results may be affected by unattended institutional variables, rather than being an exogenous variable. In their model they used numbers from 73 host countries both developed and less developed between the years of 1995 and 1999, targeting 90 % of total global inflow of FDI (ibid.). Running their model they found that the short run correlation was positive, meaning that corruption had a positive influence on FDI in the short-term. The criticism Egger and Winner (ibid.) poses towards previous research is found in Al-Sadig (2009), Smarzynska and Wei (2000) as well as other studies conducted after the study by Egger and Winner, and might imply that the earliest research on this correlation, such as Moody and Wheeler (2002) and Mauro (1995) did not accentuate the different variables that affect allocation of FDI. Additionally, although Egger and Winner (2005) find a positive correlation between FDI and corruption, they find a negative correlation between FDI and political risk. Given that the CPI index and the ICRG index both add corruption as a variable of political risk there is reason to doubt the validity of the study by Egger and Winner.

If firms are willing to pay the bribes expected of them corruption may work as a "helping hand". Consequently, if the benefits of corruption are greater than the costs, some MNCs may perhaps be willing to invest. However, knowing the exact costs of corruption has been one of the main arguments of the counterparts of

Egger and Winner (2005), such as Al-Sadig (2009) who argue that when the costs are unknown and the investment is considered risky most firms will be reluctant to do the investment at all, and thus the "helping hand" will instead be considered the "grabbing hand".

Other researchers found only a clear negative impact on FDI from corruption. Mauro (1995) argues that infrastructure, productivity of public investments, health, income inequality and productivity of public investments are affected by corruption, and these are as well important determinants for whether investors find the country viable for investments. Thus, corruption has an impact on variables deemed important for investors and thus corruption as an isolated variable can be assessed. He does as well emphasize that corruption may be a way to circumvent red tape, which might be considered a positive consequence. Kaufman and Wei (1999) found that there was no foundation for suggesting that corruption may reduce red tape. They found that investors paying bribes often used more time to negotiate with, and handle bureaucrats, than those who did not pay bribes. Thus the finding that the corruption works as a helping hand is not in line with the assumption that costs of corruption are unknown and therefore hard to quantify when investing and that corruption does not reduce red tape.

Egger and Winner (2005) used both the Transparency International perceived corruption index as their measure of corruption, and as a robustness check they added numbers from the International Country Risk Guide (ICRG). To measure FDI they used values of nominal stocks from United Nations Conference on Trade and Developments (UNCTAD's) World Investment indicators, which they further developed to real stocks. To measure market size they used the GNP numbers as the value of the market size, emphasizing the belief that greater market size leads to greater international investments in a host country; larger markets are more attractive for international investors. Thus they expected a positive impact on market size relative to inward FDI, which they found to be accurate.

Additionally, Egger & Winner (2005) added a variable related to the amount of skilled labor. They hypothesize that economies with little skilled labor is the typical receivers of FDI whilst economies with a large skilled workforce are those who typically invest in other countries. GNP and secondary school enrollment was retrieved form the WB's World Development indicators. Furthermore they

added quality of the legal system to control for the institutional quality of the legal system in host countries as a variable. This variable consisted of "independence of court systems, protection of property rights, military interference of rule of law and the integrity of the political system" (Egger and Winner 2005; 937). These are all variables that state something about the political and social state of an economy and are to a large extent variables covered by the ICRG index.

3.4.4. Missing variables in the research

A general tendency in the literature, excluding Egger and Winner (2005) and Glass and Wu (2002) is that "the grabbing hand of corruption" is present where corruption is widespread and thus "scares-off" investors. One of the main arguments supporting the hypotheses that corruption "scares" foreign investors is that of Al-Sadig (2009). Similar to Egger and Winner (2002) he criticizes previous studies for only using cross-sectional data as he believes that using only a cross-sectional study leads to omitting growth rates and other country variables that are interesting determinants of FDI inflows (Al-Sadig 2009). Further he stresses the importance of not viewing corruption as an independent variable, emphasizing that corruption is an element reflecting institutional quality in a host country. Therefore his research question is "Does a corrupt host country receive less or more FDI inflows after controlling for other determinants of FDI location?" (Al-Sadig 2009, 268). He used data from 179 countries between 1984 and 2004, and he first conducted a cross-sectional model and then a panel-data model. When he first conducted his cross sectional model he found that a 1 % increase in the level of corruption led to an 11 % decrease in FDI inflows. However, after controlling for institutional quality and other control variables through the panel-data model he found that the effect was cancelled out and in fact became slightly positive (ibid). Therefore he argues that his study explains the impact other variables may have on FDI, viewing corruption as an endogenous variable. Meaning that a country with good institutions is more likely to attract FDI than a country with poor institutions. Thus, institutional quality became for Al-Sadig, the main determinant of FDI related to the correlation with corruption. Al-Sadig (2009) and Egger and Winner (2005) thus shares a common view regarding omitted variables and the importance of model design, whilst the cross-sectional models often used in the empirical research on this correlation omits the time perspective variable captured in panels data studies. They both found that the variable of regulations or

institutional quality was the main determinant of FDI.

Studies initially finding a negative correlation between corruption and FDI generally found that by adding explanatory variables depicting market attractiveness and risk, the negative correlation decreased or even became insignificant. Kauffman and Wei (1999) also found that adding variables of institutional quality and rule of law changed the previous outcome from negative to less negative, insignificant or slightly positive. Thus, we might argue that although the literature has not concluded in its findings it is commonly found that the negative impact of corruption is an endogenous factor and cannot be treated as an isolated variable.

Contrary to several of the studies on the correlation between corruption and FDI Al-Sadig's (2009) study particularly took into account the variations of the variables explained in growth rates. This enables an understanding of how a change in the different variables changes the outcome of the correlation. Al-Sadig (2009) uses FDI per capita as the dependent variable, and the main explanatory variable is corruption taken from the ICRG index. Wishing to extend previous research he have chosen to add new variations of frequently used variables. Based on research by Chakrabarti (2001) Al-Sadig find that the only variable that shows real robustness is the host country market size measured in GDP per capita, subsequently other relatively robust variables were "openness to trade, wages, GDP growth rates, net exports, tax rates, tariffs and exchange rates" (Al-Sadig 2009, 273). Therefore he chose to control for country market size by using the growth rate of variables such as GDP per capita and population. This was done due to the belief that increase in growth rate of certain variables may be attractive to foreign investors who see potential in growing customer groups and markets (ibid.). Hypothesizing that there is a positive relationship between FDI inflows and the positive changes in variables, he expected to find that e.g. growing populations would lead to more FDI (ibid.). Openness was measured as a percentage of GDP and he expected to find a positive relationship on this as well. He further assumed that inflation is a good measure of economic stability and therefore added the variable inflation. This is in line with Al-Marhubi (2010) who found that inflation level states something about the economic stability in a country and thus its attractiveness for foreign investors.

Further, Al-Sadig (2009) controlled for human capital through percentage of secondary school enrollment and illiteracy rate. Additionally he controlled for political risk, growth rate of urban population, quality of institutions and democracy. These are common variables in the different studies on the topic, however by adding the growth rates of the variables he was able to see how change in any direction would affect MNCs willingness to invest in a country.

Conducting the cross-sectional analysis he found the same result as previous research, namely a negative impact of FDI inflows when corruption increases (ibid.). He also found that when controlling for quality of institutions the negative correlation between FDI and corruption disappears and in fact becomes slightly positive but insignificant. Al-Sadig (2009) stresses the importance of not interpreting this as if the relationship is positive, neither should it be interpreted as if corruption is not negatively correlated with FDI. Rather, the findings show that quality of institutions may be the key determinants of FDI inflow, and a country with "sound" institutions may attract FDI regardless of corruption level.

Thus the argument is that with high quality institutions it is more difficult for a bureaucrat or government official to act corrupt, and although present, corruption may not be that prevalent. Further he found that market size and market size growth was positively correlated with FDI inflows, so was market openness and quality of human capital (ibid.). Only one variable surprisingly showed an opposite direction, that was growth rate of population that Al-Sadig (2009) theorized would have a positive correlation with FDI. It is difficult to conclude whether this finding is related to the fact that more developed economies have lower population growth rates.

High political risk and unstable macro economy was negatively correlated with FDI inflow, and a larger urban population was positively correlated with FDI inflows (ibid.). He also measured the agglomeration effects, meaning that if the host country previously has received a great deal of investments, its attractiveness increases. Concluding, he found that there was a positive relationship between the level of institutional quality, democracy and the amount of FDI inflow: "For instance, a one-point improvement in the law and order index leads to an increase of about 29 percent in the per capita FDI inflows a country receives, while a democratic country receives about 10 percent more per capita inflows than an

autocratic country" (Al-Sadig 2009, 287). Law and order is another variable depicting institutional quality, which means that Al-Sadig found a positive correlation between one element of institutional quality and FDI. Of the studies presented in 3.4 the research by Al-Sadig is one of the most applicable to the research question in this thesis due to the large data set and the variation of explanatory variables used.

3.4.5. Home country corruption relative to host country corruption

Another aspect of the correlation between corruption and FDI is that of the norms and legislation on corruption in the donor country. Thus, the hypothesis is that corruption in the country of origin affects the extent to which investors invest/not invest in a host country with high corruption. Cuervo-Cazzura (2006) found that composition of home and host country corruption was crucial to whether investments across boarders took place. Investors from countries affected by the OECD convention were less likely to invest in countries with high levels of corruption than other (ibid.). Through two studies in 1997(a and b) Wei, demonstrated that host country level of corruption had a negative impact on FDI inflows equal to a supposed additional tax on foreign investors. This supposed additional tax rate was believed to be an extra 40 to 50 % of the host country tax rate. Similar to Cuervo-Cazurra (2006), Wei (2000) argues that MNC's from a country with low corruption, who also have done efforts to commit to anti-corruption initiatives, are less likely to invest in economies with high corruption levels. However, other studies argue that domestic levels of corruption are not correlated with the willingness to bribe. Hellman et al. (2000) found that less corrupt countries were equally willing to pay bribes or facilitation payments as firms from transition economies where corruption levels are perceived as higher.

3.5. Summing up: what does previous research show?

Research conducted on the relationship between FDI and Corruption differs in its conclusion as well as in its purpose. Whilst some of the studies mentioned above focus on different variables determining investments from abroad (Al-Sadig 2009, Wei 2000), other studies suggests that the relationship is dependent on the nature of the potential investment whether it is resource or market dependent (Brouthers et al. 2008) and the combination of attitudes in host and donor country (Cuervo-Cazurra 2006). However, excluding Mauro (1995), they all highlight the

importance of not viewing corruption as an endogenous variable independent of other factors. Mauro (1995) states that corruption has a negative impact on institutional variables and thus a country with high corruption will have poorer institutional quality and affect other variables depicting allocation of FDI. Both the research of Al-Sadig, Egger and Winner, Brouthers et. Al., Smarsynzka and Wei emphasize that there are a series of variables that determines allocation of FDI.

Variables presented in the empirical literature were commonly; GDP growth rates, net exports, tax rates, rule of law, economic stability measured as inflation rate, political stability, infrastructure, democracy, institutional quality, education and literacy rate of the inhabitants, and agglomeration effects. These variables are presented in table 4. Further, several of the studies suggested that corruption could be an easy way to circumvent red tape or excessive bureaucratization (Kauffman and Wei 1999). However, this was criticized by Al-Sadig (2009) and Cuervo-Cazurra (2006), who argued that costs of corruption are uncertain and thus investing is deemed risky. In particular this was applicable to foreign investors from countries with low levels of corruption. The table below identifies the different views of the research presented in this section of the thesis.

Table 2. Different views on the correlation between corruption and FDI

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                         ┌──────────────────┐
                         │  Corruption      │
                         │  and FDI         │
                         └──────────────────┘
                                  │
                         ┌──────────────────┐
                         │  Dependent on    │
                         │  other variables │
                         └──────────────────┘
            ┌─────────────────────┼─────────────────────┐
   ┌─────────────────┐   ┌─────────────────┐   ┌─────────────────┐
   │  Negative       │   │  Positive       │   │  No significant │
   │  correlation    │   │  correlation    │   │  correlation    │
   └─────────────────┘   └─────────────────┘   └─────────────────┘
```

Smarzynska & Wei	Mauro	Al-sadig, Hellman et.al	Egger and Winner	Cuervo-Cazurra	Brouthers et. al.
Cost of corruption leads to lower investments	Grabbing hand	- Cost of getting caught - Impact of other variables	"Grease the wheels" in the short run	Domestic level of corruption	Dependent on the type of resource

As we see in the table above the literature is diverging in its findings. However, there is one common factor, all the studies emphasize that corruption is endogenous. Thus the literature suggests that the correlation between FDI as the dependent variable and corruption as the main independent variable is dependent on a number of other variables that combined decides the allocation of FDI. Table 4. In section 5 presents these variables. Together these variables paint a larger picture of the socio-economic environment that is considered favorable to invest in. This model is a simplification of the research presented and the findings are more nuanced. The boxes depicting positive and negative correlation does not suggest that the researchers beneath only find a positive or negative correlation, as discussed above these are the main emphasis drawn by the researchers, yet it is still argued that correlation is dependent on other variables and therefore the main findings does not necessarily imply that there is either a positive or negative correlation.

4. Norway and corruption in FDI

In today's global scenery, Norway stands out as a unique country. Even though Norway is small in terms of population it has a strong economy and is the base for a few large MNC's. Mostly these companies focus on Oil and Gas production (Benito 2010). Norwegian MNCs are also large within power, industry, seafood, timber, IT and telecommunications. Norwegian outward FDI is characterized by few but large investments (ibid.). Relative to neighboring Nordic countries the number of Norwegian MNCs is quite low. Only a handful of large companies stand behind the considerable amount of Norwegian outward FDI, such as Statoil, Aker, Telenor and Yara/Hydro (Ibid.). Meaning that the amount of outward FDI varies according to these companies' investments on a year-to-year basis. Additionally, only a small percentage of these investments are located in developing countries.

Still, Norway has several generalizable characteristics commonly found in global FDI; most outward FDI is directed to neighboring countries, most outward FDI is connected to its main competency field, Norway has ratified the UN convention against corruption (UNCAC) as well as the OECD Anti-Bribery Convention, and Norway is an active member of a series of global anti-corruption initiatives. Contrary to many of the other UN members who have ratified the UNCAC, Norway has no informal sector of importance and low perceived levels of domestic corruption. Yet, Norway is not exempted from corruption, neither domestically nor abroad. This section will look at Norwegian FDI, Norwegian anti-corruption work and the relation to the general correlation between corruption and FDI.

4.1. Norwegian FDI in numbers

Statistics Norway show that both inward and outward FDI to Norway increased by 15 % each from 2009 to 2010, which is considered a significant increase despite the global economic recession (2011). In 2010, the sector that received the highest amount of Norwegian FDI was the Oil and Gas industry, with 23 % of the Norwegian FDI investments (ibid.). Inward FDI in the oil sector in Norway accounted for 29 % of total inward FDI. Industrial sectors, mostly manufacturing, received 21 % of Norwegian FDI in 2010. Although not a member of the European Union, most Norwegian outward FDI is allocated to the EU(Benito

2010). This is mainly due to Norway being part of the European Free Trade Association (EFTA) and the European Economic Area (EEA). Neighboring country Sweden received 14 % of combined Norwegian FDI in 2010 (ibid.). This is a general tendency in the global markets; most FDI is located in neighboring countries to the donor country.

In 2010, 65 % of Norwegian FDI was located in Europe and the US (Statistics Norway 2011). The numbers from 2010 showed a decrease in investments to these countries and an increase in FDI to other nations relative to previous years. In 2009 countries other than the US and Europe received 29 % of Norwegian FDI compared to 35 % in 2010, a 6 percentage points increase (ibid.). This might imply that there is an increase in Norwegian outward FDI to countries other than those generally considered "safe", namely the US and Europe. There may be several reasons for this, which will be discussed in section 4.2.1. The table below shows the distribution of Norwegian FDI in 2006, and compared with the statistics presented above we can see that investments are gradually dispersing to other areas than before.

Table 3. Distribution of Norwegian FDI
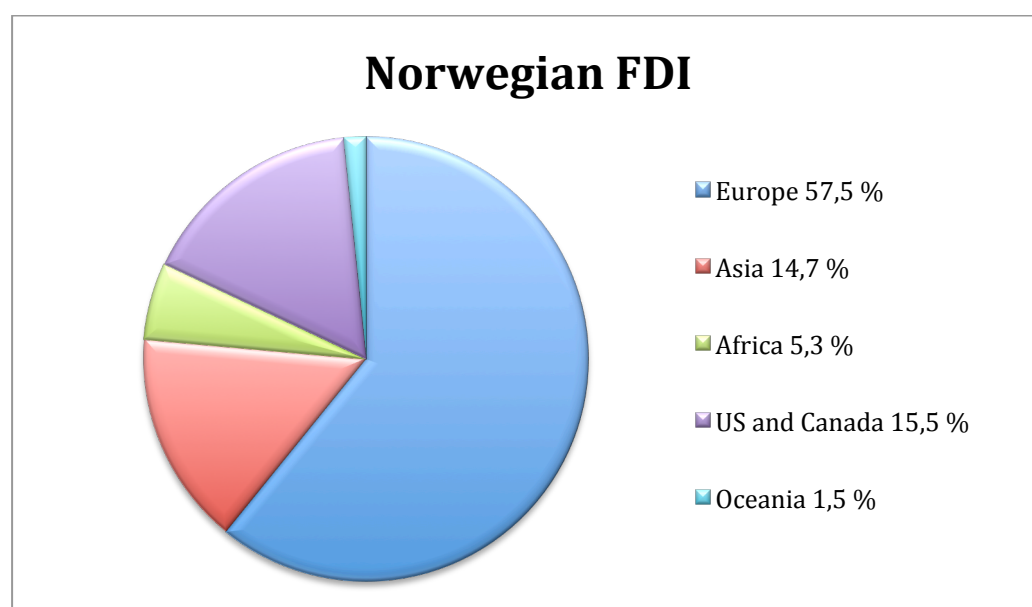
Source: Statistics Norway 2006

In the years between 1998 and 2003 Norwegian outward FDI increased by about 130 % (Nodland 2006). A significant part of Norwegian FDI is located in the oil and gas industry in countries such as Russia, Georgia, Yemen, Venezuela,

Mozambique and Iraq, all countries considered to have widespread corruption and unstable political environments (ibid.). Thus, Norwegian run FDI is subject to encounter corrupt regimes and risks when investing.

In Europe, Norway has the second highest GDP per capita, and globally it has the fourth highest GDP per capita (Statistics Norway 2012). Meaning that the relative purchasing power of Norwegians is amongst the strongest in the world, and the demand for goods is equally high. Additionally, Norway has some of the highest wages in the world combined with very low unemployment rates (Benito 2010). Thus, Norwegians are large consumers of high quality foods, high technology goods, luxury clothing, home equipment and other products usually not produced in Norway.

Although Norway is a mass importer of several items, Norwegian firms are responsive towards the increasing demands of its citizens. Consequently many Norwegian firms relocate abroad in order to sustain competitiveness in the home market as well as the global markets (ibid.). This relocation means that Norwegian firms invest in countries where equipment, facilities, labor- and production costs are cheaper. This is commonly referred to as efficiency-seeking FDI (Benito 2010, Brouthers et. al. 2008). In some instances these circumstances are in place in countries where living standards, labor rights and rule of law are not comparable to those in Norway. In many cases these countries represent different cultures than what Norwegian firms are used to. Customs considered illegal in Norway may be more acceptable in other countries, and thus Norwegian firms are likely to be subject to cultures more accepting to bribery and corruption when relocating and investing abroad.

Norwegian investments abroad have mainly been in the resource extraction industries; still, there have been a substantial increase in other types of investments during the last decades. Like Brouthers et. al (2006) Benito(2010) differs between resource-seeking and market-seeking investments when assessing Norwegian FDI. He also adds two other potential investment-seeking motives, efficiency-seeking and asset-seeking. Resource- and market-seeking is by far the most common FDI from Norwegian companies. By efficiency-seeking Benito refers to outsourcing of production and manufacturing (2010). Efficiency-seeking is a steady increasing part of Norwegian FDI.

Norwegian authorities encourage Norwegian firms to invest more in developing countries, as a means to contribute to economic growth and development. The Norwegian Ministry of Foreign Affairs (NMFA 2009) state that the low level of investments from Norwegian companies in developing countries is based on the high risk associated when investing in such countries, combined with risk of damaging reputation and increased focus on a clean profile. Thus Norfund (Norwegian Investment Fund for Developing Countries) was established as a specialized investment company under NMFA in 1997(ibid.), its purpose is to establish and provide private investments to developing countries.

CSR commitment and governmental legislation are believed to be the main reasons for why Norway in general is perceived as a highly clean country (TI 2012). In the Transparency International corruption index Norway is ranked as the world 6[th] least corrupt country (ibid.). Where 10 is highly clean and 0 is highly corrupt Norway receives a score of 9 (Norwegian govt. 2012). This is believed to be a consequence of the commitment to international initiatives as well as a non-corrupt culture, business culture and legislation. Norwegian companies are generally perceived as clean in their business transactions, albeit some have been involved in corruption abroad.

4.2. Zero-tolerance, Norwegian legislation

Up until 1995 Norwegian firms were able to deduct taxes from documented bribery of corrupt foreign officials (NHO 2012). Today the scenario is a quite different, Norwegian MNC's or individuals engaging in corruption can now be legally prosecuted for involvement in corruption. Norwegian law states that all corruption is illegal, whether committed domestically or abroad. Corruption is punishable up to three years, and up to one year for contributing (Altinn 2012). The Norwegian government acknowledges the social and economic implications corruption has on development, particularly in poor countries where the chance of revealing and punishing corrupt behavior is low. Therefore proper conduct by Norwegian firms operating abroad, particularly in countries where oversight of corruption is poor and difficult is deemed particularly important (ibid.). The penalty for corrupt behavior abroad is the same as corrupt behavior domestically. As a response to this the Norwegian Ministry of Foreign Affairs (NMFA)

acknowledges the importance of establishing anticorruption measures that will help strengthen the fight against corruption globally (2008). As well the NMFA emphasize the effect corruption has on development.

4.2.1. White papers and government announcements

By acknowledging that corruption is a challenge for Norwegian firms investing abroad, the Norwegian government has chosen to highlight the importance of clean business and anti-corruption initiatives. With regards to the low amount of Norwegian FDI in developing countries and countries with poor governance, this problem may occur quite miniscule. However, the Norwegian government has emphasized that low involvement in areas of high corruption could be due to the perceived risks and costs businesses believe to encounter if investing. Thus the NMFA states that the increased CSR expectations towards firms may lead to less Norwegian FDI in unstable areas (NMFA 2010). Domestically, the increased focus on CSR and corruption may thus have frightened firms from investing in unclean countries. General awareness of the sanctions imposed if being caught bribing has increased.

In 2009 the NMFA published a whitepaper on Corporate Social Responsibility and the role of Norwegian firms. In this report the importance of direct investments in countries with poor development was emphasized. "Direct investment is one of the most important means of providing development in poor countries" (NMFA 2009). Further the whitepaper emphasize that the government encourages Norwegian firms to engage in business in areas that do not have the same value set as Norway, this they believe is valuable both to the Norwegian firms and the societies in which they engage. Refraining to engage in a corrupt country is in the whitepaper not considered helpful to the citizens, nor the economical and political state of the country (ibid.). More it is accentuated that international business may generate important knowledge about humanitarian and social conditions in a country, and thus withdrawal may lead to worse social conditions, and political influence may disappear.

Norwegian firms may loose ground to investors from other nations that might not have the same commitment as Norway. Being replaced by other international companies can be viewed as less sustainable due to the fact that other nations may be less responsive to CSR and valuable market shares may be lost. It is especially

accentuated how China has advanced as a foreign investor in Africa, with little respect to the triple bottom line and CSR (ibid.). Although, the whitepaper emphasize the dilemma that investments in countries with poor governance poses, it encourages more flow of Norwegian FDI to these areas (ibid.). In particular the knowledge and interest of the Norwegian oil and gas industry is emphasized as an important asset.

One industry that is especially subject to corruption is the resource extraction industry in general, and the oil and gas industry in particular (Søreide 2004). Consequently, considering that Norwegian industries main competence field is oil and gas extraction and that the largest part of Norwegian FDI is located in this business, it might be argued that Norwegian firms are more likely to encounter corruption problems than MNCs not investing in this industry. This is particularly visible through the NMFA extra emphasis on cautiousness in investments in this industry (2009). Corruption in the resource extraction industry has proven to be particularly damaging to economic and social development. In 2002 Fløysand et al. interviewed a number of representatives from large Norwegian companies who had invested in developing countries. They found that the strongest reason for Norwegian companies to invest abroad was market-seeking. This finding is contrary to the previous belief that Norwegian companies are mainly resource-seeking in their investments. Nevertheless, being a resource-seeking MNC does not exclude market-seeking motives.

4.3. Strong international commitment and "codes of conduct"

As previously mentioned, Norway's commitments to anti-corruption initiatives are strong both domestically and internationally. In 2006, the NMFA started an anti-corruption initiative aimed at strengthening the criminalization of corruption globally. Its main goal is to have a universal commitment to the United Nations Conference on Anti Corruption (UNCAC), which was ratified in 2006 (NMFA whitepaper 2009). This commitment is assumed to establish higher awareness of the impacts of corruption. Both private and public firms are target groups for the convention and 148 member countries have ratified it. Ratification means that the country in subject needs to criminalize corruption, if they have not done so already (UNCAC 2012). "The Convention goes beyond previous instruments of this kind, criminalizing not only basic forms of corruption such as bribery and the

embezzlement of public funds, but also trading in influence and the concealment and laundering of the proceeds of corruption" (UNCAC 2012). More specifically it contains provisions on preventive measures, international criminal cooperation, the return of funds derived from corruption, as well as technical assistance and follow-up. Although, the convention has a broad framework there have been some criticisms towards major components of global corruption that are not included; "the Convention fails to forcefully tackle political corruption, one of the major concerns to citizens around the world. In fact transparency in political financing is a mere recommendation" (Hechler 2010, 3). This is believed to be a direct consequence of the wide definition of corruption used by the UNCAC and is considered a weakness to the importance of the ratification.

Norway is an active part of the OECD anti-bribery convention. This convention is binding for all OECD members as well as Argentina, Brazil, Bulgaria, Chile, Slovenia, Estonia and South Africa (NMFA whitepaper 2009). This conventions main focus is to decrease corruption levels in developing countries by encouraging endorsement against foreign investors engaging in bribery (OECD 2012). Norway is as well an active member of the Council of Europe's Group of States against corruption (GRECO 2012). This is the organ making sure that the member states comply with the OECD anti-bribery convention, where member states evaluate each other on a regular basis. Additionally Norway is funding anti-corruption work through the European Economic Area (EEA) financial mechanisms, and is an active contributor to the Development Banks' anti-corruption work.

In 2009 Norway also became accepted as a candidate for the Extractive Industries Transparency Initiative (EITI). This in practice meant that Norway through a two year period have had to implement EITI regulation, which ensures that all revenues from the extractive industry, domestically as well as internationally has to be reported (EITI Norway 2012). Through a stakeholder group consisting of representatives from the government, private industries and civil society, the initiative aim at ensuring that all parts of the society are incorporated in the management towards creating an evaluation, the EITI report. By implementing the EITI regulations all Norwegian companies in the extractive industry are obliged to report "all of their tax, license and royalty payments and receipts" (EITI Norway 2012). By doing so, EITI aim at making the extractive industry more transparent

both in domestic and foreign investments, and thus decrease the amount of bribes. All in all both the Norwegian government and Norwegian companies are seemingly strongly committed to CSR initiatives where anti-corruption is a large aspect, implying that Norwegian firms should be less likely to act corrupt in foreign business transaction. Sanctions of non-compliance are disclosure from the EITI, and do not imply that the company is subject for prosecutions (ibid.). EITI is a voluntary initiative and failure of complying with the principles does not have a legally binding effect.

One CSR and anti-corruption initiative directed towards companies globally is the UNs Global Compact. By sticking to the 10 principles of the GC, companies can become members. Global Compacts 10[th] principal "Businesses should work against corruption in all its forms, including extortion and bribery," is the only of the principles that directly targets corruption. According to Global Compacts homepages 36 Norwegian companies are members of the Global Compact. This includes some of the major companies such as Telenor, Yara and Det Norske Veritas (DNV) (Global Compact 2012). These are large MNCs that have invested in countries where corruption is highly prevalent. As well the Norwegian Enterprise Confederation (NHO) is a member, this means that all corporate members of NHO is subject to the principles of the global compact. Most of these firms are as well members of Transparency International and are funding the organization through yearly fees (TI 2012). Similar to EITI, the GC is a voluntary initiative. Although non-compliance may be harmful to a company's reputation there are little oversight of the companies in question (Kabadse et al. 2006). Thus, we might argue that commitment to voluntary initiatives may have a positive effect, but does not necessarily have an impact on company conduct. The UNCAC and the OECD convention have changed corruption legislation and are therefore more decisive.

4.4. Is there an actual zero-tolerance against corruption in Norway?

Considering the extensive commitment to anti-corruption initiatives and the work conducted from the governmental level it is natural to assume that Norwegian MNCs are not very likely to be involved in corruption abroad. Additionally the largest outward FDI from Norway is often lead by partly state owned enterprises such as Statoil and Telenor. However, the Norwegian interests abroad may not be possible to fulfill through acting 100 % clean. As Hveem et al. (2008) states, the

first priority of Norwegian companies operating abroad will always be to create revenue for the owners. Thus, it might be argued that if revenue can be acquired regardless of the level of corruption in a host country, corruption in itself is not the pivotal factor. There exist several examples where large Norwegian firms, also those who are partially state owned, are caught involved in bribery and corrupt behavior (NHO b 2012). Therefore the following section will evaluate the attitudes of Norwegian MNCs in FDI.

In a survey from 2004, Søreide mapped the attitudes of Norwegian firms on corruption in FDI as well as the perception of employees at Norwegian embassies abroad. The survey was based on information from in-depth interviews with executives of seven large firms, questionnaires answered by representatives from 82 firms with headquarters in Norway operating abroad, as well as a survey of the attitudes of representatives at the Norwegian embassies outside the OECD. As the only Norwegian survey of this extent the findings give an in-sight in the attitudes of Norwegian MNCs on corruption in FDI. Nevertheless, there are some important limitations to this study to consider before the results are assessed. Firstly, the respondents are executive representatives from Norwegian companies that operate abroad. Although their replies are anonymous, the respondents are still representing companies that could be assumed to have no interest in portraying their business as unclean. Thus it might be argued that the replies could be underestimated. Additionally there have been major changes to the anti-corruption awareness in the years after this survey was conducted, EITI, GC and UNCAC were all ratified or put in place after 2004. The OECD convention on anti bribery was adopted in 1997 but has gone through some major changes in the years post 2004, more countries have ratified it and its content has extended to cover more.

Nonetheless, the survey and the report give us an understanding of the underlying motives as well as the attitudes toward corruption and the anti-bribery convention. It shows that corruption and bribery is considered effective tools to obtain market shares, and that local agents helps circumvent international legislation. Lastly the survey shows that most representatives from Norwegian companies operating abroad believe that their attitudes towards corruption have remained more or less the same for a long period of time (Søreide 2004). It is therefore difficult to state

whether the changes after this survey was conducted have had any impact on the general attitudes towards corruption and bribing in FDI. Of the 82 respondents, 58 % stated that corruption in any form was unacceptable. Only 18 % found corruption to be acceptable if the alternative was not to access the market (Søreide 2004). And when asked whether they would report a competitor using facilitation payments, most of the respondents replied that they would not, fearing loss of future business cooperation. This was found to be correlated with the amount of years the firm had operated in the international markets, the more years it had operated abroad, the more tolerant it was to corruption (ibid.).

As previously emphasized a large part of Norwegian companies investing abroad are partly state-owned, such as Statoil, Telenor and Hydro. These are large companies investing in countries within and outside the US, EU and OECD countries. Hveem et al. (2009) argue that there is a difference in the conduct of stately owned enterprises (SOE's) in Norway and private owned enterprises (POE's). They claim to find evidence that SOE's are more inclined to invest in countries with poor rule of law and poor property rights than POE's (ibid.). They also expected to find that POE's were more likely to invest in countries with dictatorship and poor labor rights protection, they did however not find any evidence on this correlation (ibid.). As stated in the literature review in section 3., weak rule of law is often corresponding with high corruption levels. There may be several reasons for these findings, SOE's are in Norway often larger than POE's and may therefore have more dispersed investment portfolios, combined with larger market shares and robustness to handle unforeseen costs. Secondly the Norwegian governments encouragement to invest in developing and transition economies may affect this correlation. Thirdly SOE's may have stronger cooperation with investment agencies such as Norfund, giving stronger incentives for the SOE's to invest in countries with weak rule of law. And as previously emphasized companies that have been investing abroad for several years were more tolerant to corruption. This might as well be an explanation to the findings of Hveem et. al. (2009), that SOE's are often larger and more inclined to invest in countries where rule of law is weak.

4.4.1. Loosing contracts and avoiding investments due to corruption

Loosing contracts and avoiding investments due to corruption are challenges generally elaborated in research on corruption and Norwegian FDI. In Søreides (2004) research, one-third of the respondents answered that they had deliberately chosen not to invest in a country due to corruption, and surprisingly it is emphasized that few of the respondents were familiar with the illegality of bribes. Although the triple bottom line is commonly emphasized as important for Norwegian companies, the cutbacks in the aftermath of the global economic recession have led to great challenges to maintain this focus. And staying competitive in the global markets is the main goal of Norwegian commerce (Gjølberg 2011). In Søreide's (2004) research as many as two-thirds of the respondents replied that they believed that they had lost a contract because of corruption. Loosing contracts abroad because of strict domestic legislation on corruption is a challenge for Norwegian companies. NHO (Confederation of Norwegian Enterprises) also found that Norwegian companies in general had experienced loosing contracts due to corruption (NHO b 2012). Only during the first half of 2012 Norway has experienced two large corruption scandals with regards to their foreign FDI. What has been until today, the largest Norwegian investment abroad, Telenor's telecom market-seeking activity in India, has proved how demanding large foreign investments can be in countries where corruption is widespread (Aftenposten 2012). Telenors Indian sub company Uninor experienced difficulties, when their Indian partner Unitech was charged with corruption, which meant that a large part of the telecom licenses that Telenor had acquired were withdrawn, which resulted in major write-down for the company (ibid.). This example shows how Norwegian companies can indirectly be subject to corruption scandals, that although not illegal *per se* leads to extensive costs for a Norwegian owned MNC.

Although Norwegian companies outwards projects that they are strongly committed to CSR and anti-corruption, their practice may differ. Søreide (2004) found that the general attitude was that Scandinavian firms facilitation payments, bribing and corruption was not perceived as diverging from other MNCs, Scandinavian firms were perceived just as likely to pay bribes as any other MNC. However, stronger international commitment would mean that Norwegian and Scandinavian companies could to a larger extent refrain from corruption. Gjølberg

(2011) states that Norwegian companies in general seek stronger international regulations regarding social responsibility. This could be because Scandinavian firms are generally more committed to CSR initiatives than their global competitors. In line with the NMFA's projections these results may imply that sticking to strict CSR initiatives make firms less competitive in the global markets. By creating enforceable regulations and sanctions globally, Scandinavian firms will have a fairer competition.

If it is correct that Norwegian firms in general are tolerant to corruption abroad and are just as likely to engage in corruption than other MNC's, why do the Norwegian government concern that Norwegian MNC's refrain form investing in highly corrupt countries? Hveem et al. (2008) argue that there is not necessarily any causation in the relationship between corruption and Norwegian FDI. Meaning that there is no evident reason to why Norwegian firms have invested less in countries where rule of law is weak and corruption widespread. Norwegian firms are not believed to avoid investing in a country solely due to corruption, neither is it likely that Norwegian companies are less prone to bribe than companies from other countries (ibid.). This is contrary to the NMFA believes that Norwegian companies deliberately avoid investing in countries where corruption is high. Whilst the NMFA focus on corruption in particular, Hveem et al. (2008) focuses on rule of law, thus the findings may not be diverging rather a consequence of different definitions used, albeit generally it is believed that corruption is interconnected with poor rule of law.

4.4.2. Competition, risky investment portfolios and weak profits

Where competition is high the threshold for bribing is found to be lower. This view is emphasized on the basis that corruption deters competition in a market, giving the briber the ability to inflate prices, which again enables a monopoly situation where other firms lack the ability to enter the market (Hveem et al. 2009). In such instances it will be more tempting for firms to offer bribes in order to obtain a market share. When the market share is obtained the firm can sell its products or services to an increased price and the cost of the bribe will thus decline (Shleifer & Vishny 1993). Norway's main FDI industries are as previously mentioned oil, gas, telecom, IT and manufacturing. These were as well

those industries perceived as most exposed to corruption according to Søreide's (2004) survey. Thus, if only competing MNC's paid bribes and not Norwegian firms due to the convention, it was by the respondents perceived as being potentially damaging to Norwegian MNCs. A logical consequence of this would be that either you bribe to get a market share or you don't enter the market at all.

4.4.3. Home country legislation and commitment to conventions and initiatives

Similar to the NMFA whitepaper the respondents were concerned about the diverging legislations of the home country and the host country. Home country legislation often meant that the firms encountered obstacles when investing abroad, where customs may indicate that bribes and gifts are common. The respondents who were most concerned about these diverging customs were those most familiar with the OECD convention (Søreide 2004). In a survey from 2000 NHO found that 98 % of business representatives asked was not familiar with the OECD convention. And Søreide (2004) found that Norwegian companies aware of and committed to the anti-bribery convention emphasized to a larger extent that corruption in some cases is "part of the game". Accordingly the survey might show that those companies familiar with the convention are concerned about the implications sticking to the convention might have for business. A change in legislation on corruption does not necessarily change the behavior of Norwegian companies unless the risk of getting caught increases.

With the increased focus on CSR during the last decade most Norwegian firms operating abroad have strong anti-corruption policies as a part of their business plan (Norad/NMFA 2008). In Søredie's report 48 % of these firms stated to have routines to detect corruption and out of these, 13 % stated that they had caught an employee in being corrupt (2004). Such codes of conduct were as well found to have a negative correlation with getting contracts, meaning that firms sticking to anti-corruption codes of conduct were those firms who had experienced loosing contracts because of that. Corruption is most frequently carried out at the executive level, and that the main reason for firms not to act corrupt was the fear of "being caught in the crime" (NHO b 2012). It can be assumed that being caught in the crime is generally viewed as costly, in line with the "grabbing hand" theory.

4.4.4 Agents and local advisers

Agents, local contacts and advisers are perceived as valuable when entering a market (ibid.). Paying such agents is often referred to as facilitation payments. Such payments are not illegal, and are often subject to scrutiny because it leads to second-degree corruption. Agents have the ability to "grease the wheels" through knowledge of local customs as well as personal relationships with decision-makers that can be valuable to the firm. Thus paying for a local agent can in many ways be to pay for someone to do the corruption on behalf of the firm.

A local agent is therefore often considered as an easy way to get around international law in markets where corruption is considered normal (NHO 2012 b). When asked what the most common underlying motivation of using facilitation payments were the most common response was "the fear of loosing contracts because someone else had bribed the decision-makers" (Søreide 2004 vii). Which implies that facilitation payments are some times considered as more beneficiary than loosing a contract. There is no legislation directed at prohibiting facilitation payments in Norway. Thus countries whishing to attract Norwegian competency and investment often use facilitation payments as a tool to circumvent international and Norwegian legislation against corruption and bribery.

Nevertheless, the OECD convention states that, "each party shall take such measures as may be necessary to establish that it is a criminal offence under its law for any person intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business" (OECD 2012). Further Norwegian law states that any person who has contributed in any way to corruption or bribery is subject to prosecution (Altinn 2011). Hence, corruption through second- and third party agents can be prosecuted. However, oversight of second- and third party corruption through local agents is low, and if a country has statutory payments to local agents and start-up fees it is challenging for MNCs and home country governments to have oversight of the use of such facilitation payments. As was seen in the case of Telenor, sub contractors and third party agents can indirectly involve a company

in corruption that are damaging to the company both in terms of costs and reputation in a market.

4.4.5 What are the main motives for Norwegian FDI?

Norwegian investments are mostly determined by the market attractiveness in the host country. Companies whose main competency is fish farming invests in a country where fish farming is possible, similarly companies investing in resource extraction invest in countries that have resources. This is the general tendency in Norwegian investments abroad, whether there is a resource-seeking-, efficiency-seeking- or market-seeking investment (Fløysand et. al 2005). This is the case with most non-aid related global FDI. However, some countries that are eligible for investments are not interesting due to unfriendly business conditions. Gjølberg (2011) accentuates that the main motivation for Norwegian FDI is profits, regardless of the conditions in the potential host country.

Still, entry into markets that are not accustomed to FDI is one of the main reasons why Norwegian companies do not invest (Fløysand et. al 2005). As of bureaucratic obstacles that are correlated with corruption, Søreide (2004) emphasizes especially difficult start-up procedures, poor property rights and poor judiciary system that makes it difficult to enforce contracts. These variables are similar to the findings on the correlation between corruption and FDI in the literature review section. This might imply that Norwegian companies have the same criterions for conditions in a host country as those found in the general correlation between corruption and FDI. Thus, a Norwegian company is not necessarily more reluctant to invest in corrupt countries than other MNC's.

The "fear of being caught" was mentioned as being one of the main reasons for not to bribe when investing internationally, which might be a response to the strong sanctions imposed on any violating company (Søreide 2004). On the other hand several of the sanctions was added to the law in 2003, just one year before the survey was conducted, and few of the respondents were aware of the criminal grounds of which they could be prosecuted. There is reason to believe that this awareness has increased during the last years, and as a consequence there might be a larger consensus on the implications of being caught in corruption, and thus lower involvement in corruption and bribery.

4.5. Summing up Norwegian FDI

Norwegian legislation prohibits corruption. Most Norwegian FDI is located in Europe, and of these neighboring country Sweden receives the largest amount. The NMFA is emphasizing the importance of investing in countries regardless of the level of corruption. If the level of corruption is high the presence of Norwegian firms are believed to have a positive influence. Regardless of this the NMFA concerns that Norwegian companies are avoiding investments in corrupt countries. Both Søreide (2004) and Gjølberg (2011) found that there was not necessarily any clear relationship between corruption level in a host country and allocation of Norwegian FDI, presence of other determinants were more important. As well, Norwegian MNCs were not considered less likely to bribe than other MNCs.

Larger Norwegian firms operating abroad are generally committed to anti-corruption initiatives and often portray an ethical profile, engaging in corruption is often perceived risky and costly (NMFA 2012). Norway as a nation is as well strongly committed to anti-corruption initiative such as UNCAC, EITI, OECD convention on bribery and GRECO. As well the NMFA are actively informing Norwegian MNC's of the "grabbing hand" of corruption. In 2004, 58 % of respondents from 82 Norwegian companies stated that they found corruption unacceptable. An equally large share believed that they had lost contracts due to corruption (Søreide 2004). One third of the respondents stated that they had refrained from investing in a country due to corruption or the like. Norwegian firms were generally afraid to loose contracts to more corrupt competitors, and 18 % of the respondents found it acceptable to bribe if there was no other way to enter the market. This poses a dilemma for the Norwegian government, at one hand they recognize that the increased focused on CSR may be the reason firms refrain from investing in developing countries, on the other hand there is an emphasis on making firms commit to anti-corruptive initiatives. The combination of committing to anti-corruption initiatives and investing in corrupt areas could mean that the increased "spotlight" make firms refrain from investing in corrupt areas.
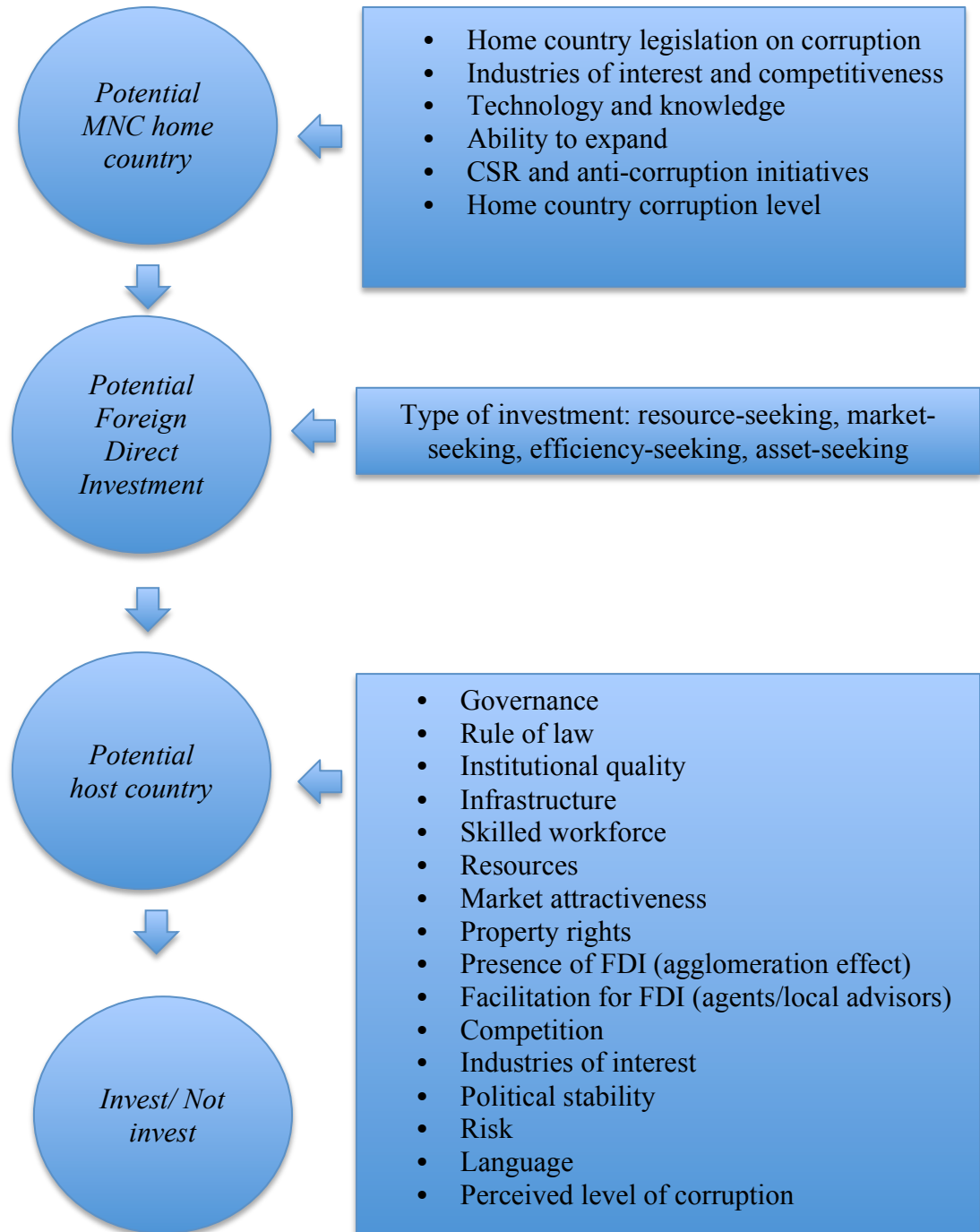
5. Discussion

5.1. Diverging findings in the literature

According to the empirical literature in this thesis it is reason to believe that countries receiving the least FDI are those countries where governance is poor, and institutional quality is weak. Correlation between poor governance and high levels of corruption are emphasized through the reports and research conducted by Transparency International and the UN Global Compact. Poor governance is thus an important parameter affecting corruption and FDI. The ICRG index emphasize that where governance is poor the social, political and economic risks of investments are higher, this could be caused by internal conflicts, low education, poor infrastructure, bribery, corrupt public officials, amongst others. In the TI survey from 2009 with respondents from major MNCs in the OECD, one third of the respondents answered that bribery and corruption were believed to raise costs of investing by 10 %. Adding the uncertainty of future costs in corrupt countries we can argue that this is in line with the "grabbing hand" theory of corruption. Corruption is costly not only for the MNC behind the investment but in general corruption is costly to the society.

Claiming that there is a clear negative correlation between corruption and FDI is difficult. Although there is reason to believe that MNCs avoid investments in countries with high perceived corruption, the review of the literature in this thesis find that there are other variables rather affecting this relationship. Elaborating the effects these variables have on the correlation enables an understanding of why some MNCs invest in countries with perceived high levels of corruption. If all the other variables that make the investment profitable are present, the perceived level of corruption may not be of importance to the firm. As well it is recognized that the investment in a corrupt country may not necessarily lead to corruption.

In order to explain all the variables affecting the determinants of a foreign investment, both from Norway and at the global level, the following model illustrates the variables affecting FDI. It is recognized that other variables than those who are presented in the model below may also have an effect on the correlation.

Table 4. Variables affecting the correlation between corruption and FDI

Potential MNC home country

- Home country legislation on corruption
- Industries of interest and competitiveness
- Technology and knowledge
- Ability to expand
- CSR and anti-corruption initiatives
- Home country corruption level

Potential Foreign Direct Investment

Type of investment: resource-seeking, market-seeking, efficiency-seeking, asset-seeking

Potential host country

- Governance
- Rule of law
- Institutional quality
- Infrastructure
- Skilled workforce
- Resources
- Market attractiveness
- Property rights
- Presence of FDI (agglomeration effect)
- Facilitation for FDI (agents/local advisors)
- Competition
- Industries of interest
- Political stability
- Risk
- Language
- Perceived level of corruption

Invest/ Not invest

As we see in the model above, perceived level of corruption in the potential host country is only a small part of the larger picture. Although this may affect the

allocation of an investment, there are a variety of other aspects that are far more accentuated. Generally the research shows that larger markets are perceived as more interesting when investing in a country, this is particularly true for market-seeking investments. Resource-seeking investments are not that considerate to market size, neither are efficiency-seeking investments (Fløysand 2005). Language might be a barrier but can be of less importance if the local knowledge is sufficient. Overall risks of investing, hereby including corruption, is by most considered an important variable. Risks include political stability, institutional quality and other investors' experiences with the market. As previously emphasized the main determinant of profit-seeking investments, is, the profitability of doing the investment.

5.2. Does Norwegian FDI fit the general correlation?

Norwegian companies face a dilemma when investing in countries with high levels of corruption. On one hand Norwegian firms are encouraged not to engage in corruption, on the other hand the NMFA encourage Norwegian firms to invest in developing country even though governance is poor. The latter is due to the positive consequences Norwegian FDI is believed to have on economic development, knowledge transfer and sustainability in developing countries. However, the "grabbing hand" of corruption becomes prevalent also for Norwegian investors, both in loosing contracts due to corruption and bribery, and because Norwegian MNCs caught bribing abroad face sanctions in the host country as well as country of origin. Additionally, corruption may affect a company's reputation and therefore lead to unknown future costs. Now that the focus has changed to be more concerned about ethics than before, MNCs have to thread more carefully when investing abroad.

5.2.1. Commitment to anti-corruption initiatives, an obstacle for business?

Norwegian firms are extensively committed to international anti-corruption initiatives. Søreide (2004) found that Norwegian companies main concern considering corruption, was that refraining from corruption would mean that competing MNC's would get contracts instead of them. We can thus ask whether anticorruption initiatives are making Norwegian firms less competitive in the international markets. If so, this poses a major dilemma for the Norwegian

government as well as Norwegian MNCs, where valuable market shares may be lost to competing MNCs if refraining because of corruption.

One third of the respondents from Norwegian firms claim to have not invested in a country due to corruption or similar problems (Søreide 2004). Example such as the case of Telenor in India may also statue a good example of the unknown costs related to investments in corrupt countries. According to these findings the view of Mauro (1995), Smarzynska and Wei (2000), Al-Sadig (2009), may be applicable to the Norwegian case study. That corruption is an obstacle for FDI in a country is true for a third of the respondents in the Norwegian survey. It can thus be argued that according to this survey it might seem as if some Norwegian investors are put-off by corruption. Likewise the NMFA whitepaper showed a concern for this approach, trying to encourage Norwegian firms to invest in countries whether or not the level of corruption is high. Gjølberg (2011) states that Norwegian companies in general seek stronger international regulations regarding social responsibility. This could be because Scandinavian firms are generally more committed to CSR initiatives than their global competitors, in line with the NMFA's projections these results may imply that sticking to strict CSR initiatives make firms less competitive in the global markets. By creating enforceable regulations and sanctions globally, Scandinavian firms will have a fairer competition.

In particular the Norwegian commitment to the OECD convention against bribery makes it difficult for Norwegian companies, whether POE's or SOE's, to bribe or contribute to corruption abroad due to the sanctions and endorsement this may lead to. Additionally, the strong commitment means that any default would lead to disclosure of the firm in subject. A disclosure may contribute to damaging a company's reputation, which again could be very costly to the company. Therefore it might be argued that such commitment makes "the grabbing hand of corruption" even more present.

5.2.2. The use of facilitation payments and agents

Corruption through facilitation payments is considered a legal way to circumvent corruption in a host country. Facilitation payments *per se* are not illegal according to Norwegian law (OECD 2009). The Norwegian survey showed that not all

MNCs found corruption unacceptable. In fact, almost one fifth of the respondents replied that it was acceptable if it was the only manner to enter a market (Søreide 2004). We might argue that there are certain limitations to the results of the survey performed by Søreide (2004) due to the fear of damaging the company's reputation, or to look more "clean" than what is the truth. And thus, it is reason to believe that the percentage in reality is larger. These results are interesting considering that the general concern of the respondents was that not being corrupt would mean that competitors would get contracts instead of them. In accordance with Smarzynska and Wei (2000) Søreide (2004) showed that Norwegian firms consider local agents to be important when entering a new market.

Norwegian MNCs are generally believed to be more committed to anti-corruption than competing MNCs and therefore risk loosing ground. In fact it might seem as both the NMFA and the firms see that CSR and anti-corruption commitment is hindering entrance in certain markets. Some actors seeking Norwegian FDI see this and thus facilitate entrance through regulations that meet Norwegian requirements. This enables market entrance in areas where Norwegian firms could normally meet challenges to stay committed to CSR initiatives. Such facilitation could in some cases mean that the host country demands a start up fee to a local agent and a yearly percentage of all revenues (NHO 2012 b). Corruption can be circumvented through the loophole of facilitation payments. It is also possible to assume that host countries are getting accustomed to anti-corruption legislations in donor countries, and that facilitation payments are becoming more common.

The relatively small share of Norwegian MNCs in general might explain why so few have invested in developing countries prior to the last years. Entry into developing countries is often more challenging than entry into more developed markets. This is particularly the case in resource extraction and telecom industries that demands an extensive research and infrastructure before entering. Nonetheless developed countries experience widespread corruption as well. More enforceable international legislation that is in line with Norwegian legislation would mean easier entry into markets that otherwise is difficult to enter (Gjølberg 2011). The increased global commitment to anti-corruption standards combined with larger involvement in development countries may imply that entry into

otherwise difficult markets have become, one hand more challenging on the other hand more facilitated.

It has been argued that Norwegian firms compared with other Nordic firms are committed to CSR initiatives due to commitment to the UN and the OECD, whilst the neighboring countries are more committed to these initiatives due to market competitiveness (Hveem et. al 2009). Although, Norway in general would like to be seen as a pioneer country regarding good governance, CSR commitment and human rights, Norway is still one of the largest suppliers of oil, gas, and electricity in Europe, and competitiveness in these markets is important.

5.2.3. Do home country corruption levels affect the correlation?

Home country corruption levels were emphasized as important determinants for allocation of FDI relative to host country corruption levels by several researchers in section 3.4.5 in the literature review. If a potential donor country had strong commitments to anti-corruption initiatives, it was found less likely to invest in countries with high corruption levels. In the Norwegian case study it was discovered that the group who was most concerned about the diverging customs of home country and recipient country were those who were familiar with the OECD convention on bribery. Therefore we might ask whether the increased attention on anti-corruption initiatives since this survey in 2004 have made more Norwegian firms concern about the same problem. Considering that this was one of the main concerns of the NMFA in the whitepaper of 2009 it might seem as this is a general concern. Thus, anti-bribery- and corruption initiatives lead Norwegian MNCs away from investing in countries with high levels of corruption.

In line with Søreide (2004), Hellmann (2006) found that there was no difference between companies willingness to bribe dependent on the level of corruption domestically. A Scandinavian firm was just as likely to bribe as a firm from a transition economy. This was contrary to the findings of Wei (1997b) and Cuervo-Cazurra (2006) who both found that home country legislation and norms had a great impact on allocation of investments relative to corruption level in recipient country. MNCs from highly clean countries are less likely to pay bribes and MNCs from corrupt countries are more likely to pay bribes. Wei (1997b) found this to be especially true when dealing with firms from OECD countries. Given

that the composition of corruption levels within OECD countries is highly diverging this would mean that in general being part of the OECD leads to less corruption. Being that Norway has ratified the OECD convention against bribery, Norwegian MNCs should thus be less inclined to behave corrupt in foreign investments.

5.2.4. Probability of being caught

There is an ethical as well as a legislative dilemma to the Norwegian case. Although International law states that corruption is illicit it is a relatively small chance of being caught in many countries. Considering the views of Al-Sadig (2009), one of the main reasons for not getting involved in a country where corruption is highly prevalent is because the probability of bribery is higher and MNC's are aware of the risks and costs of being caught. This is in line with the findings in the Norwegian study. However, firms are aware that the risk of being caught bribing in countries where bribery is considered normal is low. If a firm gets caught bribing even more bribing can solve the discrepancy (Fløysand 2005). Hence, if a firm bound by the convention, domestic law, or any other initiative against corruption, chooses to invest in a country where corruption and bribery is common and further choose to bribe, the risk of being caught may be low and the opportunity to avoid sanctions through bribery may be present. This might help explain why Norwegian MNC's still are caught acting corrupt in foreign investments. According to Søreide (2004) the correlation between level of corruption and the risk of being caught is negative and quite evident. In countries where corruption is common, there is a smaller chance for prosecution and sanctions towards corrupt behavior and thus there is less chance for foreign firms to be caught acting corrupt.

A change in legislation on corruption does not necessarily lead to less corruption unless the risk of getting caught increases. Interestingly, of the research presented in this thesis few has emphasized or drawn any attention to the correlation between the probability of being caught and the presence of a free and investigative press. Where a free and investigative press is present it could be argued that the risk of being caught in corruption increases.

6. Concluding remarks

This thesis has examined two research questions:

1.To what extent is there a correlation between corruption and Foreign Direct Investments?
2. How does the correlation between corruption and FDI relate to Norwegian FDI?

The research questions have been assessed through an analysis of the research on the correlation between corruption and FDI, as well as a case study on Norway. Evaluating the correlation between corruption and FDI has proven to be a challenging task. Although there in general are many studies conducted on this topic, they all vary in applicability and generalizability. Albeit, some interesting discoveries have been made. There is particular one common denominator between the research presented in the literature review as well as the research in the case study on Norway; corruption is not an exogenous variable and it is not necessarily the pivotal variable to the allocation of an investment.

Regardless of the included variables in the research it is common that the researcher initially finds a negative correlation between corruption and FDI. This might be a consequence of the "grabbing hand" theory - corruption as an isolated variable is not attractive for foreign investors. When adding related variables such as employment rates, market size, political stability, infrastructure, institutional quality and other variables important for allocation of investments the picture changes. In effect, some of the studies found that the previously negative correlation became positive, less negative, or insignificant, which predicts that FDI is more affected by other variables than corruption in itself. This does not mean that the "grabbing hand" theory of corruption is not accurate when assessing this correlation, rather the findings suggests that the "grabbing hand of corruption" does not necessarily interfere with an investment if other variables are present. Accordingly, investing in a corrupt country does not necessarily lead to involvement in corruption.

In the global context Norway stands as an interesting case study regarding foreign investments and corruption. Norway was among the first countries to ratify the

UNCAC. Additionally, Norway is dedicated to being a pioneer in CSR and ethical FDI. However, the picture is multi-faceted, Norway has a large industry eager to invest abroad. Profits are the main goal, regardless of the level of corruption. Norwegian FDI to countries outside the OECD has increased during the last years, indicating that the Norwegian investment portfolio is in fact expanding to other less developed areas. Norwegian firms have been subject to the grabbing hand of corruption, now most recently seen in the market-seeking investment by Telenor in India.

The findings in this thesis suggest that there are two major concerns regarding corruption as an isolated variable in the Norwegian context. However, these two concerns are diverging for the Norwegian MNCs and the Norwegian government. Both worry about loosing valuable market shares abroad, however where MNCs worry about being caught bribing abroad the Norwegian government is concerned about bribing. Zero-tolerance is imposed on the MNCs by the governmental level, but does not necessarily reflect the opinions at the corporate level.

The underlying theory for this thesis has been that of Mauro (1995), who were one of the first to find a significant negative correlation between corruption and FDI. In this thesis it is hard to draw the conclusion that this hypothesis is accurate. Although there have been studies suggesting that the hypothesis is accurate to some extent, evidence show that corruption in itself is not the main denominator for the allocation of an investment. Nevertheless, it is recognized that corruption may have an impact on the quality of variables affecting the allocation of investments. Where perceived corruption is high it is likely that the quality of variables such as political risk is lower. The findings in the research suggest that a MNC from a country with low corruption, which is highly committed to anti-corruption initiatives, is less likely to invest in countries where corruption is high. In relation to the discussion above, there is reason to suppose that this could be the case for Norway. And thus, Norway could become less competitive in FDI. It could be argued that this is yet another variable contributing to "the grabbing hand of corruption".

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Appendix: Preliminary thesis report (See next page)

Master thesis proposal

- Corruption and Norwegian FDI -

Hand-in date:
15.01.2012

Campus:
BI Oslo

Examination code and name:
GRA 19002

Programme:
Master of Science in Political Economy

Julie Haugli

Supervisor Anne Welle-Strand

Content

Research question:

Is there a correlation between corruption and FDI, and are Norwegian firms more reluctant to invest in countries where corruption is highly prevalent? (Is there any difference when the investment is related to resource extraction?)

Expected outline of the thesis

I. Summary

1. Introduction

1.1 Research question

1.2 Hypotheses

2. Methodology

3. Literature review (what is found in the literature on)

3.1. Corruption

3.2. FDI

3.3. Correlation between corruption and FDI

3.4. Oil/ Resources, does the correlation between corruption and FDI change when resources such as Oil are involved?

4. Norway

4.1. Policy papers/white papers on CSR and corruption

4.2. Interviews

4.3. Cases/incidents

5. Presentation of model

5.1. Variables

5.2. Methodology

5.3. Findings in the model

6. Discussion

7. Conclusion

8. Sources

The aim of the thesis

In the thesis I want to analyse the relationship between the amounts of FDI a country receives and the level of corruption in the host country. Research conducted on this topic mostly finds that a high degree of corruption, or an increasing degree of corruption leads to a decrease in foreign direct investment. Considering the high level of corruption in many of the countries that receives extensive FDI, such as China, I find these discoveries contradictory. Given the increased attention Corporate Responsibility (CR) has achieved during the last decade, both domestically and internationally, we see that there is an augmented focus on ethical investments. From governmental levels firms are recommended not to engage in corrupt behaviour, and there seems to be consensus on the unprofitability of investing in corrupt areas. However, we see that many multinational companies (MNC's) are investing in countries that are ranked as highly corrupt.

Research emphasise that a high degree of corruption should be associated with a higher risk when investing, and that therefore it should be a negative relationship between the perceived level of corruption and the amount of FDI in countries worldwide. Conversely, I believe that the profitability of investing in certain countries is greater than the perceived costs of corruption, thus I believe that several Norwegian companies invest in areas of interest regardless of the level of perceived corruption. Since oil technology and investments in the oil sector are some of the main interest fields of Norwegian industries I would like to look into the correlation between oil exports, corruption and FDI. If controlling for whether a country is an oil exporting country, the relationship between perceived corruption and FDI changes, I can control for whether this industrial sector have any impact of the scale of investments.

Al-Sadig (2008) found that a negative correlation could be caused by other internal factors such as regulatory quality, rule of law and political stability. By adding these variables to his regression he finds that the negative correlation becomes insignificant, giving us reason to believe that there are other factors more important than corruption in itself. In his paper he emphasize that firms in general are reluctant to invest in countries with high levels of perceived corruption. Al-

Sadig (2008) finds that a 1 % increase in the level of perceived corruption leads to an 11% decrease in FDI inflows. He emphasized, however, that after controlling for other variables such as quality of institutions, the effect is no longer negatively correlated. [1] Existing literature emphasize the relationship between corruption and FDIs, and whilst some find a clear negative relationship others find that there is a slight positive correlation, meaning that corruption to a certain level may lead to more FDI. Egger and Winner found that corruption worked as an incentive for foreign direct investment.

I find that the research conducted on this topic varies in its conclusions, although it seems, as there is consensus on that a high degree of corruption leads to less investments, we also find opposite conclusions. Research also shows that other measures of institutional quality, such as rule of law and regulatory quality are more important than corruption in itself. I find it interesting due to the low consensus on the topic. Thus I would like to present the different results of the research conducted, additionally I would like to present a quantitative research model containing similar variables as the most prominent research conducted on this topic, to see if I find any negative significant relationship between FDI and Corruption. Too highlight the Norwegian case I whish to include a qualitative part where I present interviews with officials representing large Norwegian firms operating abroad. By including this I wish to answer what motivates firms to invest in certain countries, to what extent perceived corruption is viewed as an obstacle and how we could relate these views to the global tendencies.

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[1] Sources and quotes in this proposal has previously been used in other papers by the same author; "FDI and Corruption" Term paper in Development studies; Trade, Aid and Microfinance, BI Oslo 2010. "Inflation, Seigniorage & Corruption" Term paper in Macro Economy and Political Economy, BI Oslo

How does the research question relate to existing literature?

Most existing research on the topic uses the CPI index (Perceived Corruption Index) from Transparency International. This scale ranges from 0 (highly clean) to 10 (highly corrupt). Others as well use the ICRG index on corruption ranging from 0 to 6. Thus I find that there generally are diverting views on the relationship between corruption and FDI, further two of the analyses I have looked into (Al-Sadig, Egger and Winner) found that when adding certain control variables to the regression; such as rule of law, regulatory quality and political stability, corruption in itself were less prominent. However, none of the studies included resource extraction or oil as variables. Hence, claiming that other variables than corruption are more important when attracting FDI, the literature lacks the resource variable. Thus the main controversy is whether corruption could be used as a variable explaining amount of FDI or if there are other variables that are more important. Although there seems to be some controversies regarding the subject, I find that the most prevailing theories and findings are that there is a negative relationship between corruption and FDI, meaning that a high degree of corruption will lead to less FDI.

Brouthers et al. (2008) differs between two types of FDI, market-seeking FDI and resource-seeking FDI. In their study they found that the market-seeking FDI was less sensitive towards level of corruption. Whilst resource-seeking FDI was more sensitive to level of corruption in the country they chose to invest in. This they state is because, resource-seeking FDI is based on investments aimed at cost-effectiveness relative to home costs. Thus the perceived costs of corruption may exceed the potential price level, scaring off investors. "Thus, for *resource-seeking* FDI we hypothesize that high market attractiveness cannot compensate for high corruption, and costs associated with higher corruption have a negative impact on a country's level of *resource-seeking* investment (Brouthers et al. 2008; 274) "According to Statistics Norway (2011) most FDI from Norway is in the oil and mining sector, about 70 %. Intuitively the views of Brouthers et al. would suggest that Norwegian FDI would not be directed towards corrupt countries. Most Norwegian FDI is located in Europe, which may be viewed as less corrupt than several African countries. However, some European

countries are highly corrupt. By instance Transparency International has ranked Ukraine equally corrupt as the Central African Republic and Congo (2010) with the value of 2,3 out of 10 where 0 equals highly corrupt. Thus Norwegian investment within Europe may be more subject to corruption than expected.

How will I answer the research question?

I plan to include both a quantitative and a qualitative analysis to the topic. By adding a quantitative analysis I expect to find a smaller negative relationship than previous research, in other words I expect to find that there is no substantive negative relationship between corruption and FDI. By complementing this study to the qualitative analysis I expect to find that corruption in itself is not an important factor when Norwegian firms invest abroad. Thus my hypotheses will be that there is no substantive negative relationship between corruption and FDI. I plan to create standard questionnaires and perform in-depth interviews with approx. six leaders/investment responsible representatives from different Norwegian companies. Additionally I plan to perform in-depth interviews with representatives from Transparency International and Extractive Industries Transparency Initiative (EITI) respectively. Through these in-depth interviews I expect to find what motivates and scares Norwegian firms when investing abroad. I also aim to look into the policy guidelines that have been presented by the Norwegian Ministry of Foreign affairs as well as the ethical guidelines presented by the firms themselves.

Limitations

At this stage I expect that a combination of qualitative and quantitative analyses will be the best way to answer my research question. However, I recognize that the analyses gives answers to two different questions, the quantitative analysis will explain the relationship between corruption and FDI globally (and further how oil exports affect this relationship), and the qualitative analysis explains how Norwegian firms relate to corruption when investing abroad. Nevertheless, I find that by combining these two approaches I will be able to answer my research question to the extent that I wish. I aim to explain the general global tendencies found in existing research as well as the Norwegian tendencies. I have chosen to do the quantitative analysis lastly, as I believe that there is a chance that I might find the quantitative analysis to be redundant.

Quantitative analysis

Given the relatively accessible information and quantitative measurements of the variable presented in previous research, I plan to include a quantitative analysis in the thesis. I believe that such an analysis may explain the actual relationship between FDI and corruption globally and how other independent variables may affect this relationship. Below I present the potential different variables I would like to add, in the process I find it likely that I will conclude and or extract variables. If I find that this quantitative analysis lacks robustness, I will not include it in my thesis. I have used these variables in a previous study, which I wish to develop further, this was a cross-sectional research were the variables was taken from the year 2007, hence the variables below are presented as numbers from 2007. I might want to extend the research to cover several time periods or choose another year when I further develop my quantitative analysis. The variables below gives a good understanding of the common variables used in research conducted on the same topic.

5.2. Variables

5.2.1 Dependent variable

Foreign Direct Investment as a percentage of GDP will be my dependent variable. This variable will be created using numbers for FDI inflow and GDP from United Nations Conference on Trade and Development (UNCTAD) database. Some research papers have used FDI information from the OECD database, but I have decided to use UNCTAD because 1) it provides the widest coverage of FDI inflows, although it does not have data for all countries, 2) I will look at non-OECD countries as well, and 3) I will derive the numerical data for oil exports and GDP per country from the same source. [2]

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[2] The variables presented in the quantitative analysis has been used in a previous paper from the same author; Haugli, J. & Tranøy, M. "The role of corruption and oil exports in attracting FDI". Term paper in Public Opinion and Input Politics, BI Oslo 2011

5.2.2 CPI2007

I will use Transparency International (TI) Perceived Corruption Index 2007 for the corruption data. It is measured on a scale where 10 is highly clean and 0 is highly unclean. Most of the existing research uses the International Country Risk Guide (ICRG) corruption index, but this index requires a subscription that is not available to BI student. Some researchers, however, used the TI Corruption Index as control for robustness and found that the analysis revealed the same trends as using the one from ICRG. Egger and Winner are proponents of using the CPI index. One of the reasons is that the CPI concentrates purely on corruption and is therefore "clean" of other determinants of the institutional environment, such as political instability and institutional contract risks (i.e. Rule of Law); This argument is highly relevant for why we chose this variable as our main independent variable, since we also include Political Stability and Rule of Law as control variables, although from another source. I expect the CPI2007 variable to have a negative relationship with FDIGDP – that more corruption will be perceived as more risk for investments, and therefore decrease the level of Foreign Direct Investment.

5.2.3. Main independent variable II

OILEXPGDP

I will create the variable oil export as a percentage of GDP using numbers for oil exports and GDP from the UNCTAD database. I expect this variable to have a positive relationship with FDIGDP – that an oil exporting country will have a lot of oil resources and therefore attract Foreign Direct Investment, but I also expect this variable to diminish or cancel out the expected negative effect of corruption on FDI.

5.2.4 Controlling for democracy

DI2007

There is no consensus on how to measure democracy and the various definitions of democracy are contested. I will use the 2007 Democracy Index by the Economist Intelligence Unit (EIU) as my independent control variable. The EIU is a composite democracy score rated on a scale from 0 to 10 where the aggregate score is 0 when authoritarian and 10 when highly democratic. EIU informs that there is a clear predominance of the legislature in their variable, because they

found a very strong correlation between legislative dominance and measures of overall democracy. I expect the variable to have a positive relationship with FDIGDP – that more democratic states will attract more Foreign Direct Investment.

5.2.5 Controlling for governance

I will use three governance indicators taken from the World Bank Worldwide Governance Indicators 2011 Update as independent variables to control for the quality of governance in the different countries. Variable values are rated on a scale from -2.5 (weak) to 2.5 (strong). The values reflect a statistical compilation of responses by enterprise, citizen and expert surveys.

PolStbl2007

This variable measures the level of Political Stability and Absence of Violence/Terrorism. According to the World Bank, it reflects perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism. I expect the variable to have a positive relationship with FDIGDP – that a high perceived level of political stability and absence of violence and terrorism will attract Foreign Direct Investment.

RoL2007

This variable estimates the Rule of Law governance, reflecting perceptions of the extent to which agents have confidence in and abide by the rules of society, in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. I expect the variable to have a positive relationship with FDIGDP – that a country governed by Rule of Law will attract Foreign Direct Investment.

ReqQ2007

This variable estimates the level of Regulatory Quality, reflecting perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. I expect the variable to have a positive relationship with FDIGDP – that a country with good regulatory quality will attract Foreign Direct Investment.

4.3.6 Controlling for regions

I will use the Transparency International Corruption Perception Index 2010 report's classification of countries into regions. The following regional variables will be controlled for in my final fix-effect regression to look at inter-regional differences: Americas, ASPA (Asia Pacific), EECA (Eastern Europe and Central Asia), EUWE (European Union and Western Europe), MENA (Middle East and Northern Africa), SSA (Sub-Saharan Africa).

Progress plan

January 15[th]:

Thesis proposal

February 15[th]:

Finished Literature review, what are the main findings in the literature, how trustworthy is it, what are the greatest controversies?

April 1[st]:

Interviews; develop standard questions, find interview subjects, perform interviews and analyse findings, compare with Norwegian policy papers.

April 15[th]:

Quantitative analysis, create dataset, perform analysis and analyse findings. Compare with the findings of the qualitative analysis.

May 15[th]:

Discussion and analysis

June 15[th]:

Concluding work

I expect to hand in the final thesis in the end of June 2012

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