Abstract

This dissertation builds on Cezar and Escobar's (2015) study of the relationship between institutional distance and foreign direct investment (FDI), but focuses instead on the nexus between corruption distance and FDI. Along the lines of their study, this dissertation uses a two-stage gravity model derived from the framework of heterogeneous firms to empirically estimate the impact of corruption distance on the inward and outward FDI of European transition economies. This dissertation contributes to the literature in several aspects. First, it proposes a new method for measuring corruption distance, considering the importance of firms' previous experience to the development of necessary skills for navigating a foreign business environment. Second, the empirical study distinguished the impact of corruption distance on the extensive and intensive margin by using a rich dataset with three different corruption indices, which thereby differs from most previous studies on this topic. This is also one of the few papers that specifically study this topic in the context of European transition economies. The results show that both conventional and adjusted corruption distance based on the control-of-corruption index only reduces the extensive margin of transition economies' FDI; and that the magnitude of marginal effects at the sample means is smaller when using the adjusted version. On the other hand, the results are also dependent on the original source of the corruption index used to determine corruption distance. Therefore, this dissertation indicates that the existing empirical studies on this topic are far from robust when considering the source and measurement of corruption distance in the literature.