Macro-Economic Prudence and Multinationals Investment in Latin America and Caribbean

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Abstract

Foreign direct investment (FDI) is considered indispensable by developing nations to aid in their economic development expecting that it will ensue technology and efficiency spill overs. This research paper aims at finding the impact of macroeconomic prudence on inward FDI in Latin American and Caribbean (LAC) developing economies. Using a panel of 16 LAC states from 1990 to 2023, the results by using fixed effect estimation model proves that market size, development level and openness play a significant role in attracting multinational companies (MNCs) investment. However, human capital is found to be empirically insignificant for drawing in FDI. The key macroeconomic variables under study are also significant except interest rates. It can be concluded that inflation being a signal of macro-economic instability impedes the investment decisions of foreign multinationals; secondly stable exchange rates play a substantial role in drawing FDI and lastly higher unemployment signals weak macro-economic conditions and negatively influence MNCs.

Keywords: *FDI, macroeconomic prudence, development level, trade, market size, human capital and Latin American and Caribbean countries, JEL Codes: C330, E600, F210 and F230,*

Introduction

Scarcity of available financial resources and greater need of the developing economies for them has created a competition among these nations to acquire and exploit them to their fullest for economic development (Shah, 2009). Countries strategize to attract foreign direct investment (FDI) which in turn helps to fill the income, technological and resources gap between developed and developing states (Shah, 2017d). International monetary fund (IMF) defined FDI as: it occurs when 10% of a firm's investment comes from abroad with controlling intentions (Shah & Afridi, 2015). Foreign demand can be met by multinational companies (MNCs) either through exports or through their production facilities in host countries (Shah, 2011b). The advantage of FDI for MNCs is that it creates economies of scale and allows for lower marginal cost (Shah and Qayyum, 2015). Its disadvantage is that it's an irreversible process with underutilised capacities if the market doesn't respond in the expected manner (Barry, 2024). Most developing countries face the challenge of capital scarcity for their investment ventures; hence, they seek FDI as an important source of funds for development (Shah, 2014b). Being long-term it's considered a more

effective means of capital procurement than portfolio investment or external debt (Shah, 2018a). The general idea is that MNCs invest in locations or seek hosts that generate higher profits for their investment (Shah, 2023). Vital FDI influencing factors are: Inflation, external debt, trade policies, infrastructure, exchange rate, interest rates, political and macro-economic imprudence etc. (Shah & Zeb, 2017). FDI in return carries along knowledge, managerial skills, production efficiencies, technological and capital spill over effects (Shah & Khan, 2019). Another crucial role of FDI can be financing current account deficits in trade deficit states and helping in job creation (Bouoiyour, 2007). FDI also aids in integrating developing countries in the global market place and thus, supports economic progress and healthier living standards.

Latin American and Caribbean (LAC) developing nations hold immense potential for overseas investors: Rich natural resources, a growing consumer base, strategic geographic location, and increasingly educated human capital (Shah, 2018b). However, despite these prospects, many LAC states have struggled to consistently attract and retain FDI (Shah, 2013b). A crucial reason is a recurring pattern of macroeconomic volatility including inflation spikes, debt crises, currency collapses, and erratic policy shifts (Shah, 2016c). If LAC intends to become a competitive and reliable destination for FDI, macroeconomic prudence must become a strategic priority across the region (Shah & John, 2025). World Investment Report of the United Nations Conference on Trade and Development (UNCTAD, 2024) reported $193.36 billion of FDI into LAC. ECLAC (2018), states that FDI in LAC is primarily in minerals, commodity sectors, green hydrogen, renewable energy and green ammonia. Brazil remains among the top FDI destinations in manufacturing with U.S being the largest source of FDI into the region.

Macro economy refers to the aggregate behaviour of the economy in general. We are using inflation, interest rates, exchange rates and unemployment level as proxies for it. This study is specific to LAC nations but is expected to be useful for other developing countries in understanding and realising the imperative role of macro-economic prudence for FDI in their economic progress. FDI is considered as one of the pivotal vehicles driving a nation's economic expansion through technological advancement and job creation (Alden, 2024). Macroeconomic stability is not optional for countries seeking to attract and sustain FDI (Shah & Tahir, 2024). In Latin America and the Caribbean, a region with a mixed record of economic governance, the role of macroeconomic farsightedness is even more critical (Shah, 2019). It builds investor confidence, reduces economic risks, and promotes a favourable business environment that supports long-term growth and development (Shah & Gulelala, 2017).

The paper has five parts. The first one introduces it. Part two contains the literature review. Part three represents data collection method, sample of the study, statistical software applied, estimation issues and the empirical results with different tests and checks. Part four analyse and discuss the empirical outcomes. The fifth concludes the paper.

Literature Review
Dunning (2009) OLI paradigm (i.e. O for ownership, L for location and I for internalisation) is commonly known as the "Eclectic Paradigm". It plays a dynamic role in explaining MNCs FDI decisions. According to Dunning FDI is made if ownership, location and internalisation

advantages are beneficial than trading, licensing or other arm's length modes of international businesses.

Schneider and Frey (1985) are of the view that FDI is influenced by economic and political stability and both goes hand in hand in foreign capital attraction. They conclude that their economic model accounts for 51% variance in FDI inflows as compared to the political model (40%). Mainardi (1992) analysing policy related and location specific determinants of European and Japanese FDI in Latin America and South East Asia concludes that FDI determinants usually differ according to specific home and host country characteristics and major activities of MNCs. According to him LAC attracted FDI courtesy of its economic development and large domestic markets on one hand and abundant raw materials and cheap labour force on other. The econometric analysis proved the significance of general macro-economic conditions. Policies that promote economic cooperation, domestic market liberalisation and trade facilitation all help in attracting FDI. Wang and Swain (1995) empirically showed that hosts country market size plays a vital and significant role while political instability and capital cost have negative effects on foreign inflows. Growth rates, currency depreciation and low cost labour were found to be significantly influencing FDI. Holland and Pain (1998) investigating FDI determinants in transition economies found market seeking to be the prime motive for MNCs in such economies while cost advantages playing a minor role. They also state that privatisation, liberalised product markets, as well as stable macro-economy acts as FDI stimulant. MNCs presence encourages technical progress and improves labour productivity. Equally important was the proximity between two countries.

Banik (2003), assessing FDI trends and determinants in India and China, shows that gradual exchange rate depreciation in a predictable manner lure in MNCs in both of them. Other factors such as market size seem to have different bearing in India where FDI is market seeking than that of China which is asset seeking. Bengoa and Blanca (2003) indicated through empirical investigation that FDI in LAC is positively allied with economic growth in presence of economic stability, liberalised markets and adequate human capital. FDI also assists in financial progress of an economy. Nonnemberg and Mendonça (2004) suggested that major motives behind capital flows to developed nations vary from those to developing countries. Using two different time series they found that FDI determinants are dependent on push factors: MNCs type and source country characteristics, as well as, location pull factors: Gross National Product, economy's liberalisation, human capital, inflation etc. Biglaiser and DeRouen (2006) advocated that domestic finance and trade reforms are strongly linked with and encourage FDI. Furthermore, MNCs reinvest in host countries with decreasing risk of nationalisation and higher growth prospects. Johnson (2006) exhibit that inward FDI positively sways economic growth in developing economies more than developed ones due to two reasons. Firstly, through technological spill-over, domestic firms improve their productivity and efficiency; secondly, through financial capital inflows they plugin their balance of payment deficits. Nwankwo (2006) studying FDI in Nigeria proves that there exists a significant relationship between FDI, stable macro-economy and natural resources endowments. However, political instability dissuades MNCs. The research provided evidence that stable exchange rates as well as GNP growth gives positive signal to foreign investors. According to Ponce (2006) investors perceive that trade agreements opens and liberalises the host country market, hence they invest more. Similarly, exchange rates, current account balance and privatisation schemes also significantly influence

FDI. Xing and Wan (2006) studying Japanese FDI in Chinese and ASEAN-4 manufacturing sector argued that exchange rate act as a crucial player in shaping competitiveness among FDI host countries. Relative real appreciation of the host's currency decreases FDI and diverts it to its rival. However, the research lacks plausible argument: that why, FDI in machinery isn't affected by real exchange rates.

According to Bouoiyour (2007) real exchange rate and its associated risk influences MNCs investment decision. Human capital, especially skilled labour, plays an important part in determining multinational firms' locational strategies. Moreover, trade and FDI are found to complement each other. Similarly, real exchange rate depreciation and privatisation schemes accelerate FDI inflows and help to overcome budgetary difficulties. Cevis and Burak (2007) using data from 1989-2006 for 17 countries around the globe concluded that FDI inflows have positive relationship with interest and growth rates, trade openness and also with past MNC presence. Yet, negatively related with inflation that represents economic risk. According to Greenaway et al. (2007) trade liberalisation helps to promote efficiency in more than one direction. It acts as FDI magnet in both open and closed economies. The inward FDI effect on economic growth in open economies was found to be empirically significant, however, insignificant in closed economies. Tariq and Ahmad (2007) augmented that FDI determinants are usually dependent on host country characteristics. According to them FDI has two motives, either capture domestic market (tariff jumping) or taking advantage of countries comparative advantage. FDI contributes to a State's export potential and help in overcoming balance of payment and budget deficit. Significant complementary bond was found amid exports and FDI with reverse causation. However, no evidence for substitution relationship between FDI and exports was found. The study concludes that reliable growth entice and promotes FDI.

Dinga and Daniel (2010) states that FDI inflows in medium term can be helpful in reducing unemployment but the long term impact can't be accurately drawn from initial stages. Gwenhamo (2011) says that the larger the market, greater will be FDI inflows because bigger markets provide economies of scale, which helps to achieve superior returns on foreign investments. Property rights security positively affect FDI in presence of sound macro economy due to two sided effect of GNP growth playing a major role both in attracting MNCs as well as host economy's economic growth. Ranjan and Gaurav (2011) analysing FDI in BRICS economies conclude that macroeconomic prudence, trade openness, market size, infrastructural facilities, labour cost and growth prospects are the main FDI motivators into BRICS nations.

Anyanwu (2012) says that besides natural resources, market size is a robust FDI pull factor in Africa. Similarly, openness signalling a liberalised trade approach induce MNCs. Bulent, Baris and Ercan (2012) focusing exclusively on G7 countries determined that FDI is positively and significantly related with innovation, whereas, interest rates have negative rapport with innovative activities. Huda, Karim and Fleming (2012) exploring factors affecting Malaysian manufacturing sector FDI conclude that labour productivity and market demand plays a vital role in MNCs investment decision. If government strategize to raise labour productivity in a cost effective manner, improves its citizen's purchasing power and ensure provision of better infrastructure, it will receive more FDI. Liargovas and Skandalis (2012) suggested that inward

FDI is influenced directly by trade openness in the long-run but political and exchange rate stability and market size effects FDI more profoundly.

Arbeláez and Ruiz (2013) investigating US FDI in LAC economies showed that exchange rate certainty is imperative for countries lying outside the western hemisphere. Similarly, they found that exchange rate volatility deter foreign investors. Free trade agreements helps in increasing FDI to LAC especially closeness or remoteness among participating countries acts as an antecedent for investment. Dutta and Osei-Yeboah (2013) suggested that human capital in itself is insufficient to entice increasing number of MNCs, decent political rights and civil liberties presence, channelizes the human capital to effectively attract FDI. Greater human capital in presence of weak institutions actually leads to fewer FDI inflows because of unproductive activities such as rent seeking and expropriation of assets etc. Lederman, Mengistae and Xu (2013) established that MNCs invest in countries with a competitive banking sector characterised by low interest spreads that signals lower cost of capital. They concluded that MNCs are attracted by economic and institutional stability, market size, development and education level, infrastructure, future growth prospects, law and order as well as efficient bureaucracy. The empirical evidence provided by them showed that FDI raises average firm performance and leads to high paid job creation. Shah (2013b) found macro-stability to positively influence FDI into developing economies.

Peluffo (2015) scrutinising Uruguayan manufacturing sector from 1997-2015, states that FDI increases labour productivity. Socioeconomic harmony and macro-stability enhances its welfare effects. Stoddard and Noy (2015) evaluating FDI-financial crises nexus, found that financial crises negatively influence FDI. This includes inflation, banking and currency crises. Moreover, uncertainties also reduce horizontal and vertical FDI and M&A activity. Martín and Toral (2016) focusing on Spanish FDI in LAC says that the region offers substantial benefits to MNCs, However, LACs major risks are macroeconomic vulnerabilities. Dal Bianco and Loan (2017) considering FDI in LAC, through Generalized Autoregressive Conditional Heteroscedasticity and fixed effects models found that exchange rate volatility influences FDI negatively. Shah (2018b) employing yearly FDI data for 24 LAC nations from 1989-2016, found human capital, economic development, infrastructure availability and macroeconomic stability positively influencing overseas investors. Wise and Chonn (2018) scrutinising Chinese FDI in LAC postulates that the region remains macro-economically unstable as it was in days of old. Ramirez (2019) applying Fully Modified Ordinary least Squares (FMOLS) panel estimation method postulates that exchange rate volatility and imprudent public spending hinders FDI prospects of LAC nations. Amponsah, Garcia-Fuentes and Smalley (2020) showed that MNCs seek large markets to achieve economies of scale. Remittances strengthen the market size effect. Real exchange rate has significant influence on FDI in SSA; still inflation exhibits no bearing on MNCs. Chu (2021) using firm and country level data through an ordered logit model found FDI in LAC to be swayed by healthy macro-economic fundamentals. Doyran and Gomez-Gonzalez (2024) evaluating FDI into 17 LAC nations considers fiscal and macroeconomic prudence essential for luring MNCs.

Based on the literature review the following research hypothesis are set to empirically test macro-stability and FDI rapport.

H_0: Macro-economic stability doesn't affect FDI in LAC developing countries.

H$_1$: Macro-economic stability positively affects FDI in LAC developing countries.

Data and Methodology
It's quantitative research focusing on the importance of macroeconomic prudence for FDI in LAC. Regression analysis, correlation analysis and descriptive analysis is done through Stata14. Secondary data used in the research is checked for Heteroscedasticity through Breuch-Pagen test and Multicollinearity through Variance Inflation Factor Test. The Latin American and Caribbean region consists of 34 countries in total. It's chosen because geographically it constitutes the fourth largest economic block in the world. It mostly comprises of developing countries that has achieved some progress in terms of social and institutional stability and at the same time offers variability in factors affecting FDI. Only 16 nations are chosen, based on data availability for complete data on the selected variables. These are: Brazil, Mexico, Argentina, Colombia, Ghana, Peru, El-Salvador, Dominican Republic, Costa Rica, Uruguay, Paraguay, Panama, Jamaica, Nicaragua, Barbados and Guyana. The proxies used for the variables as well as data sources are given in table one.

TABLE 1: Research Study Variables

VARIABLE NAME	PROXIES USED	DATA SOURCES
FDI	Inward FDI (lnFDI)	World Bank (2024)
Market size	Population (lnpop) GDP (current US $) (lngdp)	World Bank (2024)
Development Level	Per Capita GDP (lngdppc)	World Bank (2024)
Openness	Trade (lntrade)	World Bank (2024)
Human Capital	Secondary Education Completed (lnsc) Tertiary Education Completed (lntr) Average Years of Schooling (lnAys) Life Expectancy (lnle)	Barro and Lee (2024) and World Bank (2024)
Macro-Economic Stability	Inflation(lninfl) Exchange Rate (lnexrt) Unemployment rate (lnUnemp) Interest Rate (lnintrst)	World Bank (2024)

Empirical Equations
Foreign direct investment in LAC nation is considered a function of the variables shown in equation 1.

$$FDI_{jt} = f\begin{pmatrix} Market\ Size, Development\ Level, Openness, Trade, \\ Human\ Capital\ and\ Macroeconomic\ Stability \end{pmatrix}_{jt} \quad (1)$$

Applying natural logarithm and inserting apposite proxies for the variables utilised in equation, one, we get equation 2.

$$lnfdi_{jt} = \begin{aligned} &a_0 + \beta_1(lnPop\ or\ lnGdp)_{jt} + \beta_2 lnGdppc_{jt} + \beta_3 lnTrade_{jt} + \\ &\beta_4(lnSecdry\ or\ lnTrtry\ or\ lnAyos\ or\ lnLe)_{jt} + \beta_5 LnInfl_{jt} + \\ &\beta_6 lnExrt_{jt} + \beta_7 lnUnemply_{jt} + \beta_8\ lnIntrstrte_{jt} + \varepsilon_o \end{aligned} \quad (2)$$

Prior to carrying out the econometric analysis through fixed effect panel estimation technique, some diagnostics are carried out.

Descriptive Statistics

Descriptive statistics are numerical values that offer a quick and crisp summary of the data set. They aim to grasp crucial facets of the data to help understand its key features without the need to scan the entire dataset. Descriptive statistics usually include measures of central tendency, variability, and occasionally the distribution shape (Shah & Khan, 2017). Summary statistics allow for swift insights into the structure of the data and are essential tools in data analysis, helping to identify patterns, trends, and outliers (Shah, 2016a).

TABLE: 2 Descriptive Statistics

No	Variable	Proxy Used	Obs	Min	Max	Mean	Var	Med
1.	FDI	lnFDI	544	-0.56	3.71	1.34	0.40	1.34
2.	Market Size	lnpop	544	12.47	19.09	15.83	2.73	15.55
		lngdp	544	8.71	28.39	23.01	16.22	23.38
3.	Dev level	lngdppc	544	5.51	9.62	7.96	0.60	8.01
4.	Openness	lntrade	544	2.69	5.64	4.22	0.39	4.28
5.	Human Capital	lnsec	544	1.47	3.49	2.65	0.21	2.69
		lntr	544	0.10	2.89	1.81	0.43	1.96
		lnAys	544	1.39	2.35	1.98	0.047	2.01
		lnle	544	4.13	4.38	4.28	0.01	4.29
6.	Macro-Economic Stability	lninf	544	-2.75	8.92	2.23	1.54	2.11
		lnexrt	544	0.00	8.77	3.09	5.15	2.48
		lnUnemp	544	1.26	3.38	2.31	0.22	2.32
		lnintrst	544	0.00	18.24	3.15	11.14	2.33

Values rounded off to two decimal places

Heteroscedasticity

Through Breuch-Pagen test data heteroscedasticity is checked. It is an econometric problem in which violation of assumption of constant variance of the stochastic variable occurs (Shah & Khan, 2018). In heteroscedastic estimation one can't be sure of the standard error assessments and would be unable to make reliable forecasts beyond the range of data points applied for model fitting (Shah, 2011c). Heteroscedastic models likely lead to over-or under-estimating the coefficients impact (Shah, 2013a). The test statistics show the presence of heteroscedasticity in data. Therefore, all the regressions results robust to standard error are presented in table five and six. Following are the results of the test

$$Chi^2 (11) = 94.27 \qquad Prob > Chi^2 = 0.0000$$

Multicollinearity

Multicollinearity is an econometric problem in which the violation of the assumption of no correlation in the independent variables occurs (Shah, 2017b). It can be detected with a Correlation Matrix as well as with Variance Inflation Factor (VIF) Test.

Correlation Matrix

Correlation matrix denotes the extent of association between independent and dependent variables as well as amid themselves (Shah, 2011e). This matrix is given as table three and is

useful in judging the direction and the strength of the association amongst the variables used. Highly correlated variables if employed in the same regressions will cause extreme multicollinearity, making the regressions results unpredictable (Shah, 2018c). The relevantly low correlations between the independent variables indicate its absence.

TABLE 3: Correlation Matrix

NO.	Proxy	1	2	3	4	5	6	7	8	9	10	11	12	13
1.	lnfdi	1.00												
2.	lnop	-0.18	1.00											
3.	Lngdp	0.02	0.83	1.00										
4.	lngdppc	0.05	0.12	-0.05	1.00									
5.	lntrade	0.42	-0.77	-0.52	-0.26	1.00								
6.	lnscdy	0.29	-0.14	-0.14	0.47	0.15	1.00							
7.	lntrtry	-0.06	0.47	0.53	0.21	-0.41	0.04	1.00						
8.	lnayos	0.27	-0.26	-0.22	0.62	0.20	0.86	0.10	1.00					
9.	lnle	0.07	0.01	-0.05	0.78	-0.04	0.34	0.40	0.51	1.00				
10.	lninf	-0.30	0.22	0.20	-0.22	-0.30	-0.30	0.02	-0.34	-0.25	1.00			
11.	lnexr	0.11	-0.11	0.07	-0.27	0.25	0.04	-0.07	-0.06	-0.09	0.04	1.00		
12.	lnemp	0.10	-0.36	0.27	0.02	0.15	0.15	-0.32	0.23	-0.20	-0.24	0.00	1.00	
13.	lnintrst	-0.00	-0.04	0.06	0.03	0.01	-0.02	0.22	0.03	0.30	0.20	0.24	-0.21	1.00

All the numbers are rounded off to two decimal places

Variance Inflation Factor (VIF)

Variance Inflation Factor (VIF) Test is also used to check the econometric issue of multicollinearity in data. The VIF value for all the independent variables are shown in table four. The mean VIF value is 4.22, which indicates that there is no question of presence of excessive multicollinearity.

TABLE 4: Variance Inflation Factor

No.	VARIABLES	VIF
1.	Lnpop	8.62
2.	Lnavgschl	8.23
3.	Lngdppc	5.97
4.	Lnle	5.08
5.	Lnsecdry	5.02

6.	**Lngdp**	5.02
7.	**Lntrade**	4.21
8.	**Lntrtry**	2.42
9.	**Lnunemply**	1.70
10.	**Lnintrstrte**	1.50
11.	**Lninfltn**	1.47
12.	**Lnexrte**	1.34
13.	**Mean VIF**	4.22

Results and Interpretation

In table five, model one and two both the proxies for market size are significant. Market size plays a vital role in determining FDI location because larger market indicates greater economic activities huge numbers of buyers, better prospects for economies of scale, and diversification in tastes and preferences and higher demand for the foreign investor products and services (Amponsah et al. 2020; Shah, 2010; Shah; 2015). In third regression when LnGDPPC is added as the proxy for development level, market size turns insignificant. This exhibits that overseas investors seek larger markets but relatively developed one. Furthermore development level also represents the consumer's ability to buy MNCs products (Shah, 2011a; Shah & Azam, 2018). Therefore, the greater the GDPPC of the host the higher is the possibility for multinationals to sell their products without much ado (Chu, 2021). Including the proxy for liberalisation of the host economy Lntrade in the fourth regression the coefficients for both market size and economic progress remains significant. Hence, it's evident that in LAC region MNCs seeks open regimes encouraging the free flow of raw materials as well as finished goods (Shah & Samdani, 2015; Shah & Ali, 2016; Shah, 2017c).

Four proxies are used for Human Capital but all of them are insignificant. However, realising the significance of human capital for the MNCs manufacturing and service activities around the globe, its importance can't be ignored. Part of it may be due to the reason that with affluence usually the number of educated people increases in a country. Hence, the development level proxy may be swamping its effect (Shah, 2014a). Dutta and Osei-Yeboah (2013) say that human capital plays a decisive role only in presence of strong institutional reforms. Consequently, reforms should be taken to strengthen them.

TABLE 5: Estimation Results of Control Variables

Variable	Proxy	Reg 1	Reg 2	Reg 3	Reg 4	Reg 5
Market Size	**lnpop**	0.3923*** (0.0842)				
	lngdp		0.1899*** (0.0681)	0.0287 (0.0319)	0.0833*** (0.0161)	0.0815*** (0.0220)
Devel level	**lngdppc**			0.5012*** (0.1005)	0.4328*** (0.0886)	0.6408*** (0.1579)
Openness	**lntrade**				0.8484*** (0.1869)	1.0000*** (0.2125)
Human Capital	**lnsec**					0.0911 (0.2057)

lntrty					0.1269 (0.1145)
lnayos					-0.3410 (0.4965)
lnle					0.7882 (0.8462)
Observations	544	544	544	544	544
R²	13.2%	18.6%	22.6%	26%	30%

All the numbers are rounded to four decimal places. ***represents significance at 1%, **represents significance at 5% and *represents significance at 10%, Results are robust to standard error

Finally, we test the variables of interest that is macro-economic prudence proxies one by one in table six, from regression seven to ten. The regression result shows that except for interest rate all the other three are highly significant (Shah, 2012b). Exchange rate stability positively and increasing unemployment and inflation negatively influences multinationals (Ramirez, 2019). Let's discuss them one by one.

When a host country's currency depreciates, foreign investors may find the local assets cheaper, which can encourage FDI. It is due to the fact that cost of land, labour and other assets are cheaper in local currency (Shah, 2011d). The host country's products are more competitive in international markets, increasing exports, which could create a more attractive environment for FDI, but repatriating profits may result in reduced returns for investors. If it appreciates, foreign investors may view the market as more expensive, potentially reducing FDI. Furthermore, foreign investors from countries with feeble currencies may be dissuaded by higher investment costs. Still, profits made in the host country can be repatriated at a favourable rate, increasing FDI appeal. Highly volatile, exchange rates discourage foreign investors due to unpredictability of future returns (Dal Bianco & Loan, 2017). Fluctuating exchange rates make it difficult to predict profits when repatriating earnings back to investor's home nation.

TABLE 6: Estimation Results of Variables of Interest

Variable	Proxy	Reg 6	Reg 7	Reg 8	Reg 9	Reg 10
Market Size	lngdp	0.0804*** (0.0220)	0.0755*** (0.0216)	0.0726*** (0.0179)	0.0712*** (0.0184)	0.0675*** (0.0204)
Devel level	lngdppc	0.4330*** (0.0975)	0.4325*** (0.1005)	0.4144*** (0.0896)	0.3987*** (0.0898)	0.3532*** (0.1136)
Openness	lntrade	0.8562*** (0.1880)	0.8204*** (0.1806)	0.8101*** (0.1684)	0.8030*** (0.1642)	0.7430*** (0.1715)
Human Capital	lntrtry	0.0437 (0.1385)	0.0431 (0.1420)	0.0230 (0.1317)	0.0292 (0.1313)	0.0109 (0.1226)
Macro-economic stability	lnExrt		0.1564* (0.0809)	0.2162*** (0.0839)	0.2154*** (0.0839)	0.2030** (0.0836)
	lnUnemp			-0.2668** (0.1087)	-0.2705*** (0.1088)	-0.3596*** (0.1156)

lnIntrst				-0.0181 (0.0129)	-0.0148 (0.0095)
lnInf					-0.0578** (0.0266)
Observations	544	544	544	544	544
R²	30%	33%	37%	40%	43%

All the numbers are rounded to four decimal places. ***represents significance at 1%, **represents significance at 5% and *represents significance at 10%, Results are robust to standard error

Labour becomes affordable in high unemployment. It is especially appealing for industries like manufacturing or assembly. However, it also symbolises economic stagnation or recession, where consumer demand is low and economic growth is frail. This can reduce the attractiveness of the nation for FDI, as foreign investors might be hesitant to enter a market with limited growth potential. Nonetheless, some foreign investors may view high unemployment as an opportunity to invest in countries that are expected to recover economically (Shah, 2016b). If the state's government has policies aimed at reducing unemployment and stimulating economic progress, foreign investors may consider the country's potential development prospects. Low unemployment signals shortage of available workers, driving up labour costs. It may indicate a stable economy, which attract investors. However, if the labour market is too tight, it may create inflationary pressures and potential conflicts over wages, which could also raise concerns for FDI. In addition to probable social unrest, nations with high unemployment may also have an underutilised or underdeveloped labour force (Peluffo, 2015). If unemployment is concentrated in low-skilled workers, it could offer opportunities for FDI in industries that require unskilled labour, such as manufacturing or assembly. If high unemployment is concentrated in skilled workers, foreign investors might be less inclined to invest in industries that need specialised talent, such as tech or research-intensive sectors (Alden, 2024).

Low and stable inflation tends to make a country's economy more predictable and attractive to foreign investors. When inflation is under control, businesses can more accurately plan and project their investment, which encourages FDI. In countries with high inflation, central banks often raise interest rates to combat inflation. This can increase the cost of borrowing, which discourages both domestic and foreign investment (Stoddard & Noy, 2015). When borrowing costs are high, FDI may decline, particularly for investors who rely on financing to fund their projects. Moreover, higher interest rates can make bonds and other low-risk financial instruments (Foreign Portfolio Investment) more attractive compared to investments in risky ventures, further deterring FDI (Doyran & Gomez-Gonzalez, 2024).

Thus, summing up overseas investors in the Latin American and Caribbean Region are seeking economies with a stable exchange rate regime, low unemployment and low inflation (Martín & Toral, 2016). The insignificance of interest rates may be due to the direct inflation-interest rate connexon.

Conclusion

The given research is considering the influence of macroeconomic stability on FDI in Latin American and Caribbean Economies. Panel fixed effect model is used to empirically evaluate the data for 16 LAC countries from 1990 to 2023. Following conclusions are drawn.

Exchange rate and multinational activity exhibits a positive association. Ideally FDI-exchange rates liaison is dynamic. A depreciating currency makes an economy more attractive for foreign investors, especially in export-driven sectors, while an appreciating currency lessens a country's appeal for new FDI (Xing & Wan, 2006). Nonetheless, exchange rate volatility and uncertainty discourages FDI, as foreign investors seek stability and predictability for their investments (Shah & Faiz, 2015). Conversely, FDI inflows also influence exchange rates, as demand for local currency increases with higher levels of inward FDI. Unemployment is also significantly related with FDI inflows in LAC countries showing that increase in unemployment negatively impacts FDI inflows. Theoretically, unemployment-FDI rapport is complex and context-dependent. Greater unemployment attracts FDI due to reduced labour costs and workers availability, but it also signals weak economic conditions, dissuading investors. Low unemployment drives up labour costs, dropping FDI, but also indicating a healthy economy with lesser social unrest, which is appealing to multinationals. The interest rate coefficient though insignificant shows a negative sign. Still it shall be kept in mind that FDI-interest rates bond is multifarious and dependent on broader macroeconomic environment. While lower interest rates tend to attract FDI by lowering borrowing costs, high rates can discourage foreign investment, especially if they increase capital cost. Nonetheless, other factors like exchange rates, political stability, and overall economic conditions also significantly influence FDI decisions (Lederman et al. 2013).

Inflation being the most important measure of sound macro-economy is negatively significantly allied with FDI confirming the research studies of Ramirez (2019), Chu, (2021), Shah (2021) etc. In high inflation the cost of goods, services, and labour tends to rise increasing operational costs for businesses, reducing profitability. If foreign investors anticipate that their cost structure will be negatively affected, they are less likely to invest. High inflation creates economic uncertainty, making it difficult for foreign investors to forecast their costs and future returns, hence, making an economy less attractive for FDI, as investors prefer stability and predictability (Wise & Chonn, 2018). A state's currency typically depreciates in high inflation. This makes it attractive to overseas investors initially, however, if inflation continues to rise, it could lead to further depreciation, making profits and returns less valuable when converted back to investor's currency. This depreciation can also disrupt the stability of long-term investments, making investors wary. Moreover, hyper inflation erodes consumers' purchasing power, leading to reduced demand for goods and services. This makes the domestic market less attractive to foreign investors, especially those targeting native consumers. In addition, inflation-induced price hike cause consumers to become more price-sensitive or delay purchases, thus, harming businesses that rely on steady consumer demand. In high-inflation environments, employees often demand higher wages to keep up with rising cost of living. This increases labour costs for MNCs, making it less attractive for investment, particularly in labour intensive industries. If inflation is high but wages do not increase proportionally, labour unrest or strikes may occur, disrupting business operations and deterring further investment. Persistently high inflation is often a sign of broader economic instability, which deters FDI. Investors are less likely to commit to long-term investments in states where inflation is out of control, as it can signal other economic or political challenges (Doyran & Gomez-Gonzalez, 2024; Shah & Tahir, 2024). Lastly, FDI in developing

nations like LAC is primarily in industries like manufacturing and retail which are very sensitive to inflation, as fluctuations in input costs and consumer demand directly affect their operations and returns.

In a world of rising geopolitical fragmentation and tighter global financing conditions, LAC cannot afford macroeconomic recklessness. Countries that demonstrate consistency, credibility, discipline and prudence in their macroeconomic management shall stand out as trustworthy destinations for global capital (Shah & John, 2025). Macroeconomic prudence is not just about avoiding crisis. It is about building the foundation for sustainable, inclusive, and transformative growth through FDI. LAC nations that align their fiscal, monetary, and regulatory frameworks toward long-term stability and prudence will be best positioned to host FDI.

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