

## Chapter 6. Explaining the Foreign Direct Investment-Democracy Controversy: Normality of Regression Residuals

### Abstract

Using new data and new diagnostic techniques, chapter 6 further assesses the controversy over the relationship between democracy and FDI inflows: is it positive, negative, mixed, or is there no relationship? Chapter 6 argues that because many existing studies violate the normality assumption in linear models, their estimated results are statistical artifacts, and thus their inferences are misleading. A useful methodological correction is then offered by underscoring the importance of normality tests of regression residuals in case of small or even moderately large samples. The evidence indicates that when the fundamental assumption of normality in the data is upheld, democracies attract more FDI than do autocracies. Therefore, this chapter concludes that developing countries ought to nurture the principle of democratic governance as part of any effort to increase foreign capital for economic growth and development.