

Inequality, Autocracy and Sovereign Funds as determinants of Foreign Portfolio Equity

Flows

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Abstract

We identify new country characteristics that influence cross border equity flows: income inequality, autocracy and sovereign wealth funds. From a unique panel data set of 158 source countries and 34 OECD host countries for 2002-2013, controlling for previously established determinants of FPI, we find that OECD host countries attract more FPI from source countries with high income inequality and sovereign wealth funds and less FPI from autocracies. Countries with high income inequality invest less in tax havens while autocracies invest more. Source countries with high income inequality that also have a sovereign wealth fund or autocratic regime experience higher FPI outflows. On the other hand, source countries, which have a sovereign wealth fund and are classified as autocratic countries, do not experience higher FPI outflows. Our results are robust across many specifications, the financial crisis, size of host country capital markets, and the exclusion of the US from the OECD host countries.

Key words: foreign portfolio equity inflows, cross border equity flows, inequality, sovereign wealth funds, autocracy

JEL classifications: G28, F38, F63, H26, I3

1. Introduction

Cross-border equity flows, or foreign portfolio investments (FPI), among developed economies are theoretically determined by investment opportunities (Doukas, 1985), which are often limited due to information costs (Kho *et al.*, 2009), and yield differentials (Goldstein and Razin, 2006), *inter alia*. Market size of source and host countries are reasonable proxies for investment opportunities (Portes and Rey, 2002). Information costs or asymmetries may be proxied by a number of variables, but geographic distance has been found to be most relevant.¹ While this logic may be extended to developing economies as well (Garg and Dua, 2014; Sun *et al.*, 2002; Harms, 2002), we ask instead whether there are other country specific characteristics, economic, political and institutional, among developing countries that may be equally, if not more important. Although the financial crisis was the most significant event of the mid-2000s, there have been several subtler changes as well. First, in many developed and developing countries, there has been an increase in income inequality.² While average incomes have increased, the increase in inequality is most pronounced “in the upper parts of the distribution in most countries” (Jaumotte *et al.*, 2013). Second, perhaps not coincidentally, there has been a remarkable growth in tax havens and international tax evasion that has attracted serious attention by governments (e.g., the US Congress), the OECD, and the G-20 industrialized countries (Gravelle, 2015). Third, many countries, mainly autocracies, do not have well developed markets or democratic institutions (Olson, 1993). Economic agents in autocratic countries may behave quite differently than those in developed economies (Adam *et al.*, 2011). Fourth, resource-based economies, democratic or autocratic, have created sovereign wealth funds that

¹ See Portes and Ray (2005) for example.

² Krusell *et al.* (2000) demonstrate how efficient technology reduces income for and even replaces unskilled workers in lieu of skilled workers. They observe a significant increase in skill premium since the late 1970s, which corresponds with the increase in income inequality.

may invest differently than individual market participants in developed economies (Beck and Fidora, 2008). It appears that the equities markets may be segmented by differences in buyers. In fact, we find these individual country characteristics are as significant as the traditional determinants of cross-border equity flows found in the developed economy literature.

To show this, we construct a data set of FPI flows from 158 source countries to 34 OECD countries for the period 2002-2013. We combine these with measures of inequality, autocracy, sovereign wealth fund data, tax haven status and measures reflecting previous findings in the literature. The model specifications begin with a well-known gravity specification common in the cross-border equity flows literature.

We find that OECD host countries attract higher equity flows from countries with high income inequality and countries that have sovereign wealth funds, while less equity flows from autocratic source countries. Source countries with high income inequality send more FPI if they also have a sovereign wealth fund or represent an autocracy. On the other hand, source countries that have a sovereign wealth fund and have an autocratic regime experience lower equity outflows. Lastly, autocratic source countries invest more in tax havens, countries with high income inequality invest less in tax havens, and tax haven status has no effect on investment flows from countries with sovereign wealth funds. Specific rationales underlying these findings are developed in the hypotheses section below. The results are robust across several specifications, controlling for the financial crisis, market capitalization of host countries, and exclusion of the US from the OECD host country sample.

The remainder of the paper proceeds as follows: Section 2 reviews the literature and develops hypotheses, Section 3 introduces data and methodology, Section 4 discusses the model and empirical results, and Section 5 concludes.

2. Related literature and hypotheses

From the original gravity models of Martin and Rey (2004), Portes *et al.* (2002) and Portes and Rey (2005), in which distance was shown to be a strong proxy for information costs or information asymmetries in international trade, there have been numerous extensions that include other measures of information costs, in part to explain home bias. For example, Grinblatt and Kelohaju (2001) argue that language and culture are important as investors desire “familiarity,” such as local firm recognition or annual reports in their own language. Lucey and Zhang (2010), Kogut and Singh (1988), and Aggarwal *et al.* (2012) find that similarity in religion and culture have positive influences on FPI flows or market correlations. Further, laws that result in stronger shareholder protection and better accounting standards also have a definite effect on attracting foreign portfolio flows (Aggarwal *et al.*, 2005), especially when the home country lacks such protections (Giofré, 2014).

While information costs and various proxies are established determinants of FPI flows, recent research has started to focus on tax evasion strategies and the role of tax havens. Hanlon *et al.* (2015), Kemme *et al.* (2017), and Johannesen and Zucman (2014), *inter alia*, find evidence of source-host tax differentials as a determinant of FPI flowing through tax havens for purposes of tax evasion. Importantly, tax evaders prefer destinations that are quite different from those preferred by typical investors. Specifically, they prefer countries with obstacles to the flow of information; tax havens without tax information exchange agreements and with different legal systems; but low levels of corruption.

2.1 Inequality

An important extension within the tax evasion stream highlights income inequality (Alstadsaeter *et al.*, 2017a, 2017b). Most research on income inequality and tax evasion focuses on under-reporting (Bloomquist, 2003a, 2003b). Independent of tax evasion, Acemoglu and Robinson (2002) theorize that inequality increases with capital industrialization. This process, however, also leads to a different political policy of greater redistribution, which, hence, results ultimately in less inequality. This argument can explain the development of many European countries during the past two centuries. However, to the extent that inequality prevails, it may lead to greater FPI. Therefore, in this paper we ask whether income inequality, *per se*, is a determinant of FPI flows in general. Investing abroad rather than locally is a sophisticated adventure. Typically, those engaged in foreign investment are more educated and of substantial means (Graham *et al.*, 2009), and we would expect wealthier countries overall (as measured by GDP per capita) to have higher FPI flows. However, if income and wealth are heavily concentrated, there may be a group of individuals more likely to participate in foreign investment. Therefore, FPI flows might be greater if the total income of the country is more concentrated or income inequality is greater. If this is true, then by using the Gini index as the measure of income inequality, we expect it to be positively correlated with FPI, all else equal. Thus, our first hypothesis is:

H1: The relationship between a source country's Gini index, a measure of income inequality, and FPI is positive.

2.2. Autocracy

The concept of equality is closely related to democracy. Specifically, democracies are countries where people “should be treated equally in certain specific political respects” (Saward, 1994). The impact of political systems on equity flows, and vice versa, has long been a topic of debate. On the one hand, developing autocratic countries, where one individual holds unlimited power, might attract more inflows because investors can directly negotiate beneficial terms and conditions with the key policy maker(s) who is (are) less concerned about public opinion (Wolf, 1951; O’Donnell, 1988). Ledyeva *et al.* (2013) find evidence of this behavior, especially for investors from more autocratic and corrupt source countries. On the other hand, greater levels of autocracy lower financial openness, measured as a country’s total capital inflows and outflows relative to the country’s GDP (Aizenman and Noy, 2009). Similarly, Jensen (2003) examines the relationship between political regimes and investment flows on a dataset of 114 countries and finds that up to 70% more FDI flows into democratic countries than autocratic countries. For outflows, Brada *et al.* (2011) conclude that “government repression and regulation . . . [are] more effective in combating capital flight” in the Commonwealth of Independent States (CIS) countries; which is in line with Ghosh (2016) who suggests that autocratic regimes use capital controls to deter money from leaving.

To provide new guidance among mixed prior results, we extend the current literature by asking if autocratic source countries generate less FPI flows into the OECD than otherwise similar countries. If the autocracy posts strict capital controls on its equity outflows to prevent capital flight, we expect a negative relationship between autocracy and FPI flows. To test this hypothesis, we construct a source country autocracy dummy variable based on autocracy

measures provided by the Center for Systemic Peace (discussed in the Data and Methodology section below). Thus, our second hypothesis is:

H2: The relationship between a source country's autocracy dummy, a measure of state and political control, and FPI is negative.

Of course, the relationship may be more complicated than what is expressed in just this one hypothesis alone. Ben-Nasr *et al.* (2012) examine 236 privatized companies and find that state-owned firms experience higher cost of equity. This effect is even stronger when the firm operates in an autocratic country. Further, Acemoglu *et al.* (2002) argue that elites and politicians in autocratic countries exploit society via macro- and microeconomic policies that result in poor economic performance and high volatility. Hence, country differences in volatility do not depend *per se* on differences in macroeconomic factors but rather by the country's institutional regime. Moreover, based upon newly published BIS bi-lateral bank deposit data, Alstadtaeter *et al.* (2017) find that autocracies (e.g., Saudi Arabia and Russia) and countries with a recent autocratic history (e.g., Argentina and Greece) have very high levels of wealth held abroad. One explanation is that if investors belong to the kleptocratic elite, they would be better able to exploit society and invest those funds overseas the more autocratic their country is (Brada *et al.*, 2011). However, to generalize this idea we argue that much wealth would have to be concentrated in the upper echelon of society; hence, these countries would also have greater inequality as reflected in a higher Gini index.³ We therefore isolate autocracies with high income inequality and test if an interaction term, the product of a country's Gini index and the autocracy dummy, is positively related to FPI. Our third hypothesis is:

³ It is important to point out that in our sample the correlation between the autocracy dummy and Gini index is negative; hence, autocratic countries do not automatically present income inequality.

H3: The interaction between the Gini index and the autocracy dummy is positively related to FPI flows.

2.3. Sovereign Wealth Funds

If large concentrations of wealth within a country lead to unique patterns of cross-border equity flows, then clearly countries with Sovereign Wealth Funds (SWF) should be included in our analysis. Since 2000, the rapid increase in the size and activity of SWFs has changed the international landscape of FPI flows. Because the funds are typically designed to provide savings for future generations and also to limit the effects of resource export revenues (especially those attributable to commodity price booms) on the domestic economy, SWFs frequently invest abroad the majority of taxes and royalties arising from resource sales.⁴ This gives rise to large unidirectional cross-border equity flows. They tend to have longer term investment horizons, which makes them a stable source of cross-border liquidity. However, their quasi-public nature exposes them to political pressures that may lead to investments for non-economic reasons, contrary to long-term wealth maximization. In fact, Bernstein *et al.* (2013) show that the greater the political involvement in the management of the SWF, the greater the deviation from maximization of long-run returns. These contradictory motives are difficult to identify. Aizenman and Glick (2007, 2009) find that countries with SWFs tend to have relatively lower scores on democracy indices than industrialized, developed countries, but higher than less developed countries. At the same time, they also have lower effective governance scores than developed countries, but higher than that of less developed economies. Consequently, as a group they tend to be unique – occupying a middle range in between developed and less developed

⁴ See Kemme (2012) for details.

countries on democracy and government effectiveness scales.⁵ With combined assets of about USD 7.4 trillion, these funds certainly have the wherewithal to affect cross-border equity flows.⁶ Most of these economies are relatively small in the sense that non-oil GDP is small and, thus, sophisticated and wealthy individual investors are few. Therefore, we would expect most FPI to be channeled through the SWF rather than individual investors. They are not immune, however, from the actions of a kleptocratic class of investors. Because national wealth is concentrated in the fund and the objective is to move it out of the country, we would expect FPI to be higher than in countries with comparable GDP and GDP per capita. Thus, we test the following hypothesis:

H4: The relationship between countries with SWFs and FPI is positive.

It should be noted that SWF countries are not identical in their purpose, investment objectives, legal status or institutional policies.⁷ Their performance and the ability to monitor their activities also varies. Truman (2010) compares the transparency scores he calculates across subgroups and some clear conclusions emerge.⁸ Three findings that are relevant for our analysis can be summarized as: “1) for non-pension SWFs, those from OECD countries have Truman transparency scores much higher than non-OECD countries; 2) of non-OECD SWFs, the non-Middle East SWFs score higher than the Middle East SWFs; 3) of the non-OECD SWFs Asian SWFs score higher than non-Asian SWFs” (Kemme, 2012). If autocracies are associated with a lack of transparency (Eldredge, 2016), we should expect some distinction between the behavior of FPI flows from SWF countries that are autocratic and those that are not.⁹ The autocracy dummy may pick up an important difference in the behavior, or even purpose, of the SWF.

⁵ For detailed analysis of SWF transparency, which sheds some light on the motives of funds, see Truman (2010).

⁶ Sovereign Wealth Fund Institute, <https://www.swfinstitute.org/sovereign-wealth-fund-rankings/>

⁷ See Alsweilem *et al.* (2015a, 2015b) for profiles of 12 large SWFs and wealth management policies that guide them.

⁸ See Truman (2010) Table 5.2, among others.

⁹ Note that Aggarwal and Goodell (2018) show that the governance component of the Truman transparency score is also influenced by national cultural characteristics based on Hofstede *et al.* (2010).

While some countries might truly use SWFs as an investment for the benefit of future generations (Beck and Fidora, 2008; Truman, 2007; *inter alia*), authoritarian regimes might use the funds to ameliorate social discontent or prevent possible revolutions against the country's political leadership (Ross, 2015; Bueno de Mesquita and Smith, 2010). If resources must be used to maintain the support of citizens now and avoid a collapse of the autocratic political regime, fewer resources are available to invest abroad compared to democratic countries with SWFs. As a result, FPI flows from autocratic SWF countries would be lower than for SWF countries in general. Thus, we isolate autocracies with SWFs by constructing an interaction variable that is the product of the autocracy and SWF dummies to test the following hypothesis:

H5: The interaction of the autocracy dummy and the SWF dummy is negatively related to FPI flows.

Similarly, income inequality and SWFs may be interrelated and have an effect on FPI flows. They are both hypothesized to have a positive effect on FPI flows, and here the interaction should be complementary. While there may be high inequality now, as evidenced by a high Gini index, leading to higher FPI flows, the intent of SWF managers might be to provide future income from the higher current FPI outflows. These future incomes are presumably for the benefit of the currently "disadvantaged" in a society with great income inequality. If both individual effects are positive, the interaction should be positive as well, adding even more to FPI flows from countries that have both high income inequality (perhaps kleptocratic) and SWFs. Thus, we test the following hypothesis:

H6: The interaction between the SWF dummy and the Gini index is positively related to FPI flows.

2.4. Tax havens and tax evasion

Our analysis naturally lends itself to extending the tax evasion literature by considering how the newly evaluated country determinants of FPI might change if funds flow into a tax haven host country. Previous studies show that more FPI flows into tax havens than non-tax havens (Hanlon *et al.*, 2015; Kemme *et al.*, 2017). Hence, the host country tax status is important. At the same time, if more FPI comes from countries with higher income inequality (greater Gini index), then these funds originate from a select few investors with possibly enough “personal power” not to be concerned about taxes in their home country. However, if income is more equally distributed among a larger body of average citizens with less “personal power,” they are likely to be more scrutinized by the tax authorities and have a greater incentive to shift their wealth into tax havens. Thus, we test

H7: The interaction between a country’s Gini index and the tax haven dummy is negatively related to FPI flows.

If indeed autocratic regimes put stricter capital controls on equity outflows of their citizens (Li, 2006), it becomes harder for individuals to invest overseas. In this situation, the motivation for sending funds to tax havens would more likely be based on risk diversification than tax savings. Therefore, to send money out of a restrictive economy against official directives, citizens would likely select tax havens as host countries to maintain anonymity, avoid the sharing of tax information and, hence, their detection of illegal activities. Thus, we test the following hypothesis:

H8: The interaction between the source country autocratic dummy and the tax haven dummy is positively related to FPI flows.

In a final test, we explore if the existence of a SWF in a country is related to FPI through tax havens. Because the FPI is originating mainly from the SWF, rather than individual investors, there would also be little incentive for tax evasion strategies.¹⁰ Thus, we would expect there to be less FPI through tax havens than otherwise, or perhaps no statistically significant flows. Our final hypothesis is:

H9: The interaction between the SWF dummy and the tax haven dummy is either negatively related to FPI or insignificant.

3. Data and Methodology

We focus on the impact of a source country's level of income inequality, political regime, and sovereign wealth fund status on foreign portfolio equity flows. The dependent variable is *Log (FPI)*, the natural logarithm of foreign portfolio investment a host country receives from each foreign source country in our sample in each year. We obtain foreign portfolio investment (FPI) flows from the IMF Coordinated Portfolio Investment Survey Database (CPIS). Our final sample consists of 16,339 FPI flows from 158 source countries into 34 OECD host countries between 2002 and 2013. We retain country pairs with at least three observations and equity flows of a minimum of USD 1 million (Kemme *et al.*, 2017).

We use the *Source Gini index* to determine the impact of source countries' level of income inequality on FPI. This data is obtained from the World Bank database. The Gini index measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. A Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality.

¹⁰ This is an overstatement of course, as in nearly all SWF countries there is a segment of society of very high income individuals who have accumulated significant wealth and may also invest in tax havens. The SWF flows would dominate though.

Since this data is not available for all source countries, our final sample consists of 8,669 observations when we test the impact of income inequality on FPI flows.

In order to better understand the impact of the political regime in a source country on FPI flows, we create a *Source Autocratic Country Dummy* based on Polity Scores provided by the Center for Systematic Peace (CSP). Autocracy is defined as a political system that lacks regularized political competition. CSP provides an 11-point score that measures competitiveness of political participation, the regulation of participation, the openness and competitiveness of executive recruitments and constraints on the chief executive of the main political party.¹¹ Our source autocratic country dummy takes the value of 1 when autocratic scores are greater than or equal to 4, and 0 otherwise. Autocratic scores greater than or equal to 4 represent the 90th percentile observations for our sample. Autocratic scores are unavailable for some source countries in our sample; hence our final sample drops to 15,033 observations when we test the impact of autocracy on FPI flows.

To test the impact of sovereign wealth funds (SWF) on FPI flows, we create a *Sovereign Wealth Fund Dummy*, which takes the value of 1 when a source country has a SWF, and 0 otherwise. We obtain this data from Bagnall and Truman (2013) for each source country, and our dataset contains 16,639 observations when we examine the impact of SWF on FPI. Table A1 in the appendix lists the host countries, source countries, autocratic source countries, source countries with SWFs, and host countries with developed capital markets.

In the analysis that follows, we also include well-established determinants of FPI flows. *Log (Distance)* is the natural logarithm of the distance in kilometers between the source and host country, and we expect a negative coefficient for this variable to account for the home bias

¹¹ Autocracy Scores and details may be found at the Polity Project (<http://www.systemicpeace.org/inscr/p4manualv2016.pdf>)

(Aggarwal *et al.* 2012, *inter alia*).¹² *Identical Language* is a dummy variable equal to 1 if the source and host country speak the same official language, and 0 otherwise. Since familiarity with the language in the host country increases foreign investments (Aggarwal *et al.* 2012, *inter alia*), we expect a positive coefficient for this variable. Distance data are obtained from Mayer and Zignago (2011) and Language data are obtained from Melitz and Toubal (2014). Because investor protection is found to be greater in common law legal systems relative to civil law systems, we construct a *Common Law* dummy variable equal to 1 if the host country has a common law legal system, and 0 otherwise. Legal family data are obtained from La Porta *et al.* (1998), and we expect the coefficient for this variable to be positive since more equity flows into countries with a common law legal system that protects investors better than the civil law legal system (La Porta *et al.*, 2000; Globerman and Shapiro, 2002). We further control for the size of the economy since the level of development and population size also influence FPI flows. Alfaro *et al.* (2004) and Amaya and Rowland (2004) find foreign direct investments tend to move to large and developed markets and we expect FPI to do the same; hence, we expect positive coefficients for the *Log (Host Country GDP per Capita)* variable. Similarly, we expect a positive coefficient for the *Log (Source Country GDP per Capita)* variable since FPI should increase with wealth in the source country (Kristjánssdóttir, 2005; Duade and Fratzcher, 2008). GDP and population data are obtained from the World Bank database.

The characteristics of the equity market, the actual exchanges, are emphasized in Thapa and Poshkawale (2010), highlighting the importance of transaction costs, and Thapa and Poshkawale (2012), showing that investors prefer larger, more developed economies where the capital market

¹² As an alternative distance measure, Hellmanzik and Schmitz (2017) show that virtual proximity, captured by bilateral internet hyperlinks, impacts bilateral portfolio investment. Due to the nature of our variables of interest and focus on tax havens, we use the traditional geographic distance variables.

is more liquid and more efficient. Thus, we include *Log (Host Country Market Capitalization)* as a measure of the depth and development of the financial markets in the host country. In line with Aggarwal *et al.* (2012) we expect the coefficient of this variable to be positive. *Withholding Tax Rate (%)* is the tax rate for foreign investors on dividend income. This rate depends on whether the host and source country have signed and ratified a bilateral double taxation treaty. We obtain this data from the American Enterprise Institute (AEI) International Tax Database and KPMG Individual Tax Rate Survey.¹³ Countries with a lower tax burden will attract higher foreign investment; hence, we expect the coefficient for *Withholding Tax Rates (%)* to be negative. Lastly, we control for a host country's tax haven status using a *Host Tax Haven Dummy*, which is equal to 1 if the host country is considered a tax haven, and 0 otherwise. Following Kemme *at al.* (2017), we classify a country as a tax haven if it was included in the Harmful Tax Competition Report (OECD, 1998) or in the classification based on Hines and Rice (1994), and we expect the coefficient to be positive. We provide variable names, definitions and sources for all variables in Table A2 of the appendix.

Table 1 reports the descriptive statistics of the variables used in the study. The average equity flow between the host and source country in our sample is approximately USD 6.9 billion. Forty percent of the source country sample has a sovereign wealth fund. In general, the mean market capitalization of listed companies for all host countries in our sample is USD 1.6 trillion, with a maximum of USD 19.94 trillion for companies listed in the US. The average distance between two capital cities is 6,023 km, with a minimum of 160 km (Austria- Netherlands) and a maximum of 19,516 km (New Zealand- Spain). Fifteen percent of the country pairs share an identical language and 23 percent have a common-law legal system. Three percent of the host

¹³ To verify data accuracy, we compare similar tax rate data from other accounting firm publications and find that our tax rates are consistent across these publications.

countries in our sample are tax havens. Since our sample consists of inflows into OECD countries, the average GDP per capita for host countries (USD 42,989) is greater than the average GDP per capita for source countries (USD 24,839). Approximately ten percent of source countries are autocracies. The average source country Gini index is 35.6 %, with a minimum of 23.7% for Slovenia and a maximum of 64.8 % for South Africa. Table 2 provides the correlation table for the variables we employ. There are no unusually high correlations between independent variables. Consequently, we do not find multi-collinearity in the regression analysis below.

Insert Tables 1 and 2 about here.

4. Model and Empirical Analysis

4.1 Model specification

Our basic model is a gravity equation derived from Martin and Rey (2004). The initial specification is designed to identify the effects of income inequality, autocracy and SWFs on FPI flows. The dependent variable is the log of equity flows from source to host country, $\text{Log}(FPI)$. The main independent variables of interest are the *Source Gini Index*, *Source Country Autocracy Dummy* and *Source Sovereign Wealth Fund Dummy*. We expect positive signs for source country Gini index and SWF dummy, and a negative coefficient for the autocracy dummy. The basic regression model and variants may be written as:

$$\text{Log}(FPI)_{ij,t} = \beta_1 \begin{pmatrix} \text{Source Gini Index}_j \\ \text{Source Country Autocratic Dummy}_j \\ \text{Source Sovereign Wealth Fund Dummy}_{j,t} \end{pmatrix} + \beta_k X_{i,j,t} + \text{Year Fixed Effects}_t + \epsilon_{ij,t} \dots$$

(1)

where β_1 is a three-element row vector and all variables are as defined in the previous section.

$X_{i,j,t}$ is a vector of other determinants of FPI flows, including $\text{Log}(\text{Distance})$, $\text{Log}(\text{Host GDP})$

per Capita), *Log (Source GDP per capita)*, *withholding tax rate (%)*, *Identical Language* dummy, *Common Law* dummy, *Host Tax Haven* dummy, and the various interactions discussed as hypotheses above. Collectively, these variables effectively control for home bias and country specific characteristics such as equity market features and transactions costs. β_k is a vector of the corresponding coefficients of the variables in $X_{i,j}$. We add year fixed effects to account for unmeasured determinants that vary over time. We estimate using clustered standard errors, by host country and year, to provide consistent standard errors and appropriate coefficient test statistics.¹⁴

4.2 Empirical Analysis

To determine the effects of inequality, autocracy and SWFs on FPI flows, we estimate equation 1 and several variants thereof. In each variant, we keep year fixed effects and cluster standard errors by host country and year.¹⁵ The baseline model results are reported in Table 3. We find that in the baseline model, and all specifications in later tables, the conventional determinants of FPI flows have the correct signs and are statistically significant. Specifically, proxies for market opportunities and characteristics (*Log (Source Country GDP per capita)*, *Log (Host Country GDP per capita)* and *Log (Host Country Market Cap)*) all have positive and statistically significant coefficients, and proxies reflecting information costs also have the appropriate negative (*Log (Distance)*) and positive (*Identical Language* and *Common Law*) signs. *Withholding Tax Rates (%)* is negative and significant, indicating that international tax policies, such as double taxation agreements, which reduce overall taxation for foreign investors,

¹⁴ Clustered standard errors in the panel data setting yield unbiased and asymptotically (in the number of cross sections) efficient standard errors (Peterson, 2009; Thompson, 2011).

¹⁵ Both host and source fixed effects were dominated by the control variables in the model, which effectively picked up all of the country specific characteristics.

play an important role. These results are very robust and orthogonal to our core variables and all of the interactions that are of interest. In this sense, we confirm the findings in the literature for these determinants in our sample, which is more expansive than past studies, and now focus on the main hypotheses in turn.

If income inequality in the source country is positively related to FPI flows (H1), β_{11} in equation (1) above must be positive. The baseline model result in Table 3 Model II confirms our first hypothesis. The coefficient for income inequality (Source Gini index) remains positive and statistically significant in every model estimated with this variable included (Tables 4 and 5), thus providing strong evidence that income inequality in the source country leads to greater FPI outflows, *ceteris paribus*.

Insert Table 3 about here.

The coefficient for source autocratic country dummy, β_{12} , shows the predicted negative and statistically significant sign in Model III of Table 3. Hence, we confirm our hypothesis H2 that autocratic source countries send less FPI than democratic source countries. Again, this coefficient remains negative and statistically significant in all other models (see Tables 4 and 5), hence providing strong evidence that a country's political regime has a significantly negative impact on FPI flows. This finding supports the claims that autocratic countries impose stricter capital controls on their citizens' outflows to prevent capital flight.

Table 3, Model IV tests if SWF countries have higher FPI outflows than other countries of comparable size. As expected, the coefficient for the SWF Dummy, β_{13} , is positive and statistically significant. The coefficient remains positive and is statistically significant in all but one of the additional models in Tables 4 and 5. Therefore, we support H4 and can conclude that

countries with SWFs are investing abroad at higher rates than comparable countries without SWFs.

The base line models and those that follow provide strong evidence to not reject H1, H2, and H4, indicating the importance of inequality, autocracy and sovereign wealth funds. However, these characteristics are not mutually exclusive, and countries that exhibit a combination of these characteristics may behave differently. Thus, the next hypotheses look more closely at country characteristics and their interactions. Three models in Table 4 report the interaction results to test H3, H5 and H6, and the models in Table 5 add tax haven and additional interactions to the baseline model to test hypotheses H7, H8 and H9.

Insert Table 4 about here.

Model I in Table 4 confirms that the coefficient of the interaction between autocracy and income inequality is positive and significant. In support of H3, this result suggests that higher inequality in autocratic source countries is related to higher FPI flows. While foreign investment is often discouraged for the general public in autocracies to prevent capital flight, countries with great income inequality have a small group in the upper echelons of society with both personal power and wealth. This group, therefore, has the means and likely the ability to invest abroad. Hence, FPI flows are positively impacted when funds are generated in autocratic countries with great income inequality.

For hypothesis H5 we examine whether autocratic countries with SWFs engage in less FPI than SWF countries in general. We argue this could be the case if autocracies need to use part of their national savings to maintain domestic order. If part of the SWF must be used to maintain high levels of employment and civil order, fewer funds are available to invest overseas. As

predicted, the coefficient on the interaction term is negative and statistically significant in Table 4, Model II, supporting H5.

We test hypothesis H6 in Model III, Table 4. The coefficient for the interaction variable identifying countries with SWFs and high income inequality is positive and statistically significant. Hence, countries that currently experience more unequal income distribution seem more inclined to save for future generations via SWFs than countries with more equal income distribution, confirming hypothesis H6.

In Table 5 we detail the role of tax havens and their influence on how income inequality, autocracy and SWFs effect FPI flows. Model I examines hypothesis H7, the interaction between income inequality and tax havens; Model II focuses on hypothesis H8, the interaction between sovereign wealth funds and tax havens; and Model III tests hypothesis H9, the interaction between autocracy and tax havens. In all specifications, we find that the coefficient on the host tax haven dummy is positive and statistically significant. This implies that the benefits of investing in tax havens, providing a highly beneficial tax regime and relative anonymity, are clear to foreign investors with such preferences.

Insert Table 5 about here.

Table 5, Model I, reports that the coefficient for this interaction between the Gini index and tax haven is negative and statistically significant, supporting H7. Here, we argue that if the majority of a country's wealth is residing with a select few, those individuals typically enjoy sufficient "personal power" such that they are not subjected to probes by tax authorities and do not require tax havens to shelter their funds. However, if income is more evenly distributed, and more individuals have an incentive to conserve their wealth, the typical individual has less "personal power" and tax authorities are more likely to investigate suspicions of tax evasion.

Hence, investors have a greater incentive to use tax havens in countries with more equal income distribution.

Investors from autocratic countries are expected to be interested specifically in anonymity, especially if the country's regime imposes strict capital controls on outflows to prevent capital flight. If individuals in those countries illegally invest overseas, they would want the protection of anonymity and prefer investing into tax havens. Thus, the coefficient on the interaction term between the tax haven and autocracy dummies should be positive. Table 5, Model III, confirms hypothesis H8.

Hypothesis H9 identifies the flows from countries with SWFs into tax havens. In these countries, we would expect investors, mainly the SWF itself, to invest without regard to tax haven benefits since they are a state entity to begin with. Model II in Table 5 reports that the coefficient on this interaction term is insignificant, confirming hypothesis H9. This result indicates that investors from these countries are not focused on tax savings or anonymity. FPI flows are driven by more traditional determinants of foreign portfolio flows (GDP, language, distance, etc.).

4.3 Robustness Tests

Finally, to check the robustness of the results for all of the models above we re-run the basic models using different sub-samples. Our original sample includes the global recession, 2008 – 2009, which altered international financial flows. To ensure the results are unaffected by this unusual period, we re-run the models excluding observations from 2008 and 2009. These results are presented in Panel A of appendix Tables A3, A4 and A5 and are comparable to results

presented in Tables 3, 4 and 5. The magnitudes and statistical significance of the coefficients for the variables of interest are similar.

Because the US market capitalization is about 40% of total global market capitalization, the magnitude of FPI flows into the US could have a large influence on the estimation results. To determine if the US flows overly influence the estimation results, we re-run the models removing the US from our host country sample. The results are presented in panel B of appendix Tables A3, A4 and A5. Again, the results are comparable in magnitude and statistical significance to those of Tables 3, 4 and 5.

Lastly, we acknowledge the preference for making investments in well-developed capital markets (Thapa and Poshakwale, 2012). Therefore, we test if our results hold for this important sub-sample. Specifically, we use the MSCI Capital Market classifications developed, emerging, frontier and stand-alone capital market indexes.¹⁶ The new sub-sample excludes thirteen OECD countries that are not classified as ones with a developed capital market. The results in Panel C of appendix Table A3, A4 and A5 indicate that all hypotheses, H1 through H9, are again confirmed. Thus, the results are robust across all of our sub-samples and specifications.

5. Conclusion

We find that income inequality, political regime (autocracy vs. democracy) and existence of a sovereign wealth fund (SWF) are important determinants of cross-border equity flows. We also confirm that determinants commonly referenced in the literature hold as well and complement our findings. The results provide meaningful feedback to policy makers, especially in host countries, and also contribute to the investment and tax evasion literature. The new determinants

¹⁶ <https://www.msci.com/market-classification>

we identify provide additional guidance for potential host country authorities' efforts to attract funds from specific countries or regions. Some source countries, for example those with a SWF, may provide a stable source of funds and be an attractive investor with a long-term view, and do provide a larger flow of foreign portfolio investment (FPI) than countries otherwise comparable. However, other source countries, with unequal distribution of income, have been identified as providing more FPI than otherwise comparable countries, but they may be less desirable if source country stability is negatively affected by income inequality. Further, autocracies may be a less likely source of incoming FPI and might require closer attention by host country authorities as these flows are likely to be determined by a fewer number of potential investors. Source countries that have high income inequality and have a sovereign wealth fund or are autocratic countries experience higher equity outflows. On the other hand, source countries that have a sovereign wealth fund and also have an autocratic regime experience lower equity outflows. We also find that countries with sovereign wealth funds or high income inequality do not invest in tax havens, but autocratic countries invest in tax havens to maintain anonymity. Host country authorities promoting local investment opportunities should be aware of these differences. Future research at a more disaggregated level or with micro level data may be informative in examining the cross-border equity flows of these source countries.

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Table 1: Descriptive Statistics

This table presents descriptive statistics for all variables. *Equity Flows (million\$)* is total inflows received by the host country from a source country in each year. *Sovereign Wealth Fund Dummy* is a binary variable taking the value 1 when a source country has a Sovereign Wealth Fund; 0 otherwise. *Withholding Taxes (%)* is the withholding tax rate applied by the host country on the source country dividend income based on existing double taxation agreement. *Host Country Market Cap (billion \$)* measures the market capitalization of all listed companies in the host country. *Distance (KM)* is the distance between two capital cities in kilometers. *Identical Language* is a dummy variable taking the value 1 when host and source share a common language; 0 otherwise. *Common Law* is a dummy variable taking the value 1 when the host country has a common law legal system; 0 otherwise. *Host Country GDP per Capita (\$)* is the GDP per capita of the host country for a given year in USD. *Source Country GDP per Capita (\$)* is the GDP per capita of the source country for a given year in USD. *Host Tax Haven* is a dummy variable taking the value 1 when the host country is classified as a Tax Haven; 0 otherwise. *Source Autocratic Country Dummy* is a binary variable taking the value 1 when a source country has autocratic scores greater than 4; 0 otherwise. *Source Gini Index (%)* measures income inequality of the source country. See Table A2 of the Appendix for sources. N is the number of observations. Std Dev is the standard deviation of each variable.

Variable	N	Mean	Std Dev	Minimum	Maximum
Equity Flows (\$ MN)	16639	6994.73	31205.94	1.00	758411.00
Sovereign Wealth Fund Dummy	16639	0.40	-	0.00	1.00
Withholding Taxes (%)	16639	16.46	6.72	0.00	47.00
Host Country Market Cap (\$ BN)	16639	1675.81	3764.98	1.13	19947.28
Distance (KM)	16639	6023.84	4578.26	160.93	19516.56
Identical Language	16639	0.15	-	0.00	1.00
Common Law	16639	0.23	-	0.00	1.00
Host Country GDP Per Capita (\$)	16639	42989.55	21117.88	3576.23	113738.73
Source Country GDP per Capita (\$)	16639	24839.52	22906.83	130.91	112028.57
Host Tax Haven	16639	0.03	-	0.00	1.00
Source Autocratic Country Dummy	15033	0.10	-	0.00	1.00
Source Gini Index (%)	8689	35.56	8.41	23.70	64.80

Table 2: Correlation Table

This table presents the Pearson correlation between each pair of variables. All variables are as defined in Table A2 of the Appendix. ***, **, * indicate statistical significance at 1%, 5% and 10% respectively

Variable	Sovereign Wealth Funds Dummy	Withholding Taxes (%)	Host Market Cap (\$BN)	Distance (KM)	Identical Language	Common Law	Host Country GDP per Capita (\$)	Source Country GDP per Capita	Host Tax Haven	Source Autocratic Dummy	Source Gini index(%)
Sovereign Wealth Funds Dummy	1										
Withholding Taxes (%)	-0.0566***	1									
Host Market Cap (\$BN)	-0.0394***	0.1762***	1								
Distance (KM)	0.3183***	0.2019***	0.1952***	1							
Identical Language	-0.0337***	0.1085***	0.2561***	0.0811***	1						
Common Law	-0.0009	0.0109	0.5010***	0.2390***	0.3856***	1					
Host Country GDP per capita (\$)	-0.0106	0.0346***	0.0269***	0.0042	-0.0173**	-0.0273***	1				
Source Country GDP per Capita (\$)	0.0406***	-0.0885***	-0.0891***	-0.1945***	-0.0019	-0.0250***	-0.0975***	1			
Host Tax Haven	0.0013	-0.1044***	-0.0763***	-0.0078	0.0890***	0.3366***	0.0513***	-0.0006	1		
Source Autocratic Dummy	0.1828***	-0.0120	0.0285***	0.0604***	0.0491***	0.0124	0.0769***	-0.1296***	-0.0149*	1	
Source Gini index (%)	0.3527***	0.2545***	0.0516***	0.4976***	0.0862***	0.0333***	0.0209**	-0.4965***	0.0193*	-0.0281***	1

Table 3: Baseline Model Results

This table presents OLS results with year fixed effects and standard errors clustered by host country and year. The dependent variable is Log (Equity Flows) the logarithm of portfolio equity inflows from source country to a host country for each year. All variables are as defined as in Table 1 above and in Table XY of the Appendix. Model I presents the base line results. Specification II includes the Sovereign Wealth Fund Dummy Variable with the base model. In specification III Source Autocratic Dummy variable is included and in specification IV we have included Source Gini Index. ***, **, * indicate statistical significance at 1%, 5 % and 10 % level respectively.

Parameters	I	II	III	IV
Source Gini Index		0.0856*** (0.004)		
Source Autocratic Country Dummy			-0.9903*** (0.072)	
Sovereign Wealth Fund Dummy				0.7370*** (0.030)
Host Tax Haven	1.5436*** (0.217)	1.3926*** (0.215)	1.3811*** (0.215)	1.5178*** (0.220)
Withholding Taxes (%)	-0.0331*** (0.004)	-0.0452*** (0.005)	-0.0456*** (0.005)	-0.0274*** (0.004)
Log(Source Country GDP per Capita)	0.8121*** (0.018)	1.4522*** (0.033)	1.0132*** (0.021)	0.7552*** (0.017)
Log(Host Country GDP per Capita)	1.3945*** (0.094)	1.4962*** (0.110)	1.5413*** (0.101)	1.3809*** (0.095)
Log(Host Country Market Cap)	0.4609*** (0.021)	0.5065*** (0.028)	0.4896*** (0.024)	0.4696*** (0.022)
Log(Distance)	-0.2058*** (0.025)	-0.4258*** (0.037)	-0.1551*** (0.027)	-0.3584*** (0.025)
Identical Language	0.7196*** (0.052)	1.0179*** (0.086)	0.8715*** (0.052)	0.7109*** (0.053)
Common Law	0.1381 (0.107)	0.2584* (0.148)	0.1446 (0.116)	0.2170** (0.107)
Year Fixed Effects	Yes	Yes	Yes	Yes
No of Observation	16639	8689	15033	16639
R Square	0.9847	0.9884	0.9869	0.9850

Table 4: Baseline model with interactions

This table presents OLS results with year fixed effects and standard errors clustered by host country and year. The dependent variable is Log(Equity Flows) the logarithm of portfolio equity inflows from source country to a host country for each year. In specification I, we introduce Source Gini index, Sovereign Wealth Fund Dummy variable and their interaction with control variables from baseline model in Table 2 specification 1. In specification II, we introduce Source Gini Index, Sovereign Autocratic Dummy variable and their interaction with control variables from baseline model in Table 2 specification 1. In specification III, we introduce Sovereign Wealth Fund Dummy, Sovereign Autocratic Dummy variable and their interaction with control variables from baseline model in Table 2 specification 1. All variables are as defined in Table A2 of the Appendix. ***, **, * represent statistical significance at 1%, 5 % and 10 % level respectively.

Parameters	I	II	III
Source Gini index	0.0811*** (0.004)		0.0659*** (0.006)
Source Autocratic Country Dummy	-3.7428*** (0.716)	-1.0034*** (0.092)	
Sovereign Wealth Fund Dummy		0.9063*** (0.026)	0.0182 (0.235)
Source Gini index * Source Autocratic Dummy	0.1263*** (0.022)		
Source Autocratic Country Dummy * Sovereign Wealth Fund Dummy		-0.3368*** (0.119)	
Source Gini Index * Sovereign Wealth Fund Dummy			0.0135** (0.007)
Host Tax Haven	1.3263*** (0.217)	1.3284*** (0.217)	1.3869*** (0.218)
Withholding Taxes (%)	-0.0430*** (0.005)	-0.0416*** (0.005)	-0.0431*** (0.005)
Log(Source Country GDP per Capita)	1.5284*** (0.038)	0.9415*** (0.020)	1.4102*** (0.033)
Log(Host Country GDP per Capita)	1.5435*** (0.104)	1.5259*** (0.103)	1.4842*** (0.111)
Log(Host Country Market Cap)	0.5114*** (0.029)	0.5026*** (0.025)	0.5147*** (0.029)
Log(Distance)	-0.4284*** (0.037)	-0.3402*** (0.027)	-0.5097*** (0.038)
Identical Language	0.9423*** (0.089)	0.8465*** (0.054)	1.0570*** (0.085)
Common Law	0.2790* (0.154)	0.2573** (0.116)	0.3055** (0.179)
Year Fixed Effects	Yes	Yes	Yes
No of Observation	8513	15033	8689
R Square	0.9890	0.9873	0.9883

Table 5: Baseline with Tax Haven Results

This table presents OLS results with year fixed effects and standard errors clustered by host country and year. The dependent variable is Log (Equity Flows) the logarithm of portfolio equity inflows from source country to a host country for each year. All variables are as defined in Table 2 of the Appendix. Model 1 presents the results including host tax haven dummy and source Gini index along with their interaction. Model 2 presents the results including host tax haven and Sovereign Wealth Fund dummies along with their interactions. Model 3 presents the results including host tax haven and Source Autocratic dummies along with their interaction. Model 4 has host tax haven, Sovereign Wealth Fund and Source Autocratic dummies and source Gini Index along with their interactions. In each model we have the base model from Table 2 Model 1 which includes control variables. ***, **, * represent statistical significance at 1%, 5 % and 10 % level respectively.

Parameters	I	II	III
Source Gini index	0.0864*** (0.004)		
Sovereign Wealth Fund Dummy		0.7374*** (0.031)	
Source Autocratic Country Dummy			-1.0101*** (0.073)
Source Gini index * Host Tax Haven	-0.0291** (0.015)		
Sovereign Wealth Fund Dummy * Host Tax Haven		-0.0141 (0.105)	
Source Autocratic Country Dummy * Host Tax Haven			0.7826*** (0.228)
Host Tax Haven	2.4522*** (0.515)	1.5235*** (0.219)	1.3205*** (0.215)
Withholding Taxes (%)	-0.0449*** (0.005)	-0.0274*** (0.004)	-0.0457*** (0.005)
Log(Source Country GDP per Capita)	1.4520*** (0.033)	0.7552*** (0.017)	1.0137*** (0.021)
Log(Host Country GDP per Capita)	1.4956*** (0.110)	1.3809*** (0.095)	1.5422*** (0.102)
Log(Host Country Market Cap)	0.5056*** (0.028)	0.4696*** (0.022)	0.4900*** (0.024)
Log(Distance)	-0.4345*** (0.037)	-0.3584*** (0.025)	-0.1553*** (0.027)
Identical Language	1.0181*** (0.087)	0.7109*** (0.053)	0.8675*** (0.052)
Common Law	0.2584** (0.148)	0.2171** (0.107)	0.1455 (0.116)
Year Fixed Effects	Yes	Yes	Yes
No of Observation	8689	16639	15033
R Square	0.9884	0.9850	0.9869

Appendix

Table A1: Host countries, source countries, autocracies, SWF countries and tax haven countries

Host Countries	Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, South Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States
Source Countries	Afghanistan, Albania, Algeria, , Angola, Anguilla, Antigua and Barbuda, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belgium, Belize, Bermuda, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Bulgaria, Burkina Faso, Cape Verde, Cambodia, Cameroon, Canada, Cayman Islands, Chile, Hong Kong, China, Colombia, Democratic Republic of Congo, Republic of Congo, Costa Rica, Cote d'Ivoire, Croatia, , Cyprus, Czech Republic, Denmark, Dominica, Dominican Republic, Ecuador, Egypt, El Salvador, Equator Guinea, Estonia, Ethiopia, Finland, France, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea – Bissau, Guyana, Hungary, Iceland, India, Indonesia, Iran, Iraq, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, South Korea, Kuwait, Republic of Kyrgyz, Laos, Latvia, Lebanon, Lesotho, Liberia, Libya, Lithuania, Luxembourg, Macedonia, Madagascar, Malawi, Malaysia, Maldives, Mali, Malta, Mauritania, Mauritius, Mexico, Moldova, Mongolia, Montenegro, Morocco, Mozambique, Namibia, Nepal, Netherlands, New Zealand, Nicaragua, Niger, Nigeria, Norway, Oman, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Portugal, Puerto Rico, Qatar, Romania, Russia Federation, Rwanda, Saudi Arabia, Senegal, Serbia, Seychelles, Sierra Leone, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sri Lanka, St Kitts and Nevis, St Vincent and Grenadines, Swaziland, Sweden, Switzerland, Taiwan, Tanzania, Thailand, Togo, Trinidad and Tobago, Tunisia, Turkey, Uganda, Ukraine, United Arab Emirates, United Kingdom, United States, Uruguay, , Venezuela, Vietnam, Yemen, Zambia, Zimbabwe
Source Countries with Sovereign Wealth Fund	Algeria, Angola, Australia, Azerbaijan, Bahrain, Brazil, Canada, Chile, Hong Kong, China, Colombia, Equator Guinea, France, Gabon, Ghana, Iceland, Indonesia, Iran, Ireland, Japan, Kazakhstan, Korea, Kuwait, Latvia, Libya, Malaysia, Mauritania, Mexico, Mongolia, Netherlands, New Zealand, Nigeria, Norway, Oman, Panama, Peru, Qatar, Russia, Singapore, Thailand, Trinidad and Tobago, Uganda, United Arab Emirates, United States, Venezuela, Vietnam
Autocratic Source Countries	Algeria, Angola, Azerbaijan, Bahrain, Bangladesh, Belarus, Cameroon, China, Republic of Congo, Egypt, Equatorial Guinea, Ethiopia, Gabon, Gambia, Iran, Jordan, Kazakhstan, Kuwait, Laps, Morocco, Nepal, Oman, Pakistan, Qatar, Rwanda, Saudi Arabia, Singapore, Swaziland, Thailand, Togo, Uganda, United Arab Emirates, Venezuela, Vietnam, Zimbabwe
Host Countries with Developed Capital Markets as per MSCI	Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States

Table A2: Description of Variables and Sources

Variable	Description	Source
Ln (Equity Flows)	Logarithm of equity flow from source country, which is the country of origin, to a host country, which is the intended destination. It is in millions of USD.	IMF-CPIS
Identical Language	Dummy variable taking the value 1 when both host and source countries share a common language, and 0 otherwise.	CEPII
Common Law	Dummy variable taking the value 1 when host country follows a common legal practices, and 0 otherwise	La Porta <i>et al.</i> (1998,)
Distance	Distance between two capital cities or two financial centers measured in km.	CEPII
Host GDP Per Capita (\$)	The ratio of GDP in USD of the host country divided by the population of the host country	WorldBank
Source GDP per Capita	The ratio of GDP in USD of the source country divided by the population of the source country	WorldBank
Host Market Capitalization (\$)	Market Capitalization of all the listed companies in USD	WorldBank
Sovereign Wealth Fund Dummy	Dummy Variable taking the value 1 when a source country has a sovereign wealth fund and 0 otherwise	Bagnall and Truman (2013)
Source Gini Index	This measure the income inequality in the source country with score from 0 -100 with a higher score indicating higher income inequality	WorldBank
Source Autocratic Dummy	Dummy variable taking the value 1 if autocratic scores greater than 3 or 0 otherwise	Center for Systemic Peace
Host Tax Haven	Dummy variable taking the value of 1 if country of reception of flows is considered as a tax haven, and 0 otherwise.	Hines and Rice (1994) and Harmful Tax Competition report (OECD, 1998)

Table A3: Robustness Results- Base Models

This tables presents the robustness results with specifications similar to Table 3. In panel A we remove the recession years (2008, 2009) from the sample. In Panel B we remove USA as host country from the sample. In Panel C we have a sample of host countries which are classified as developed capital markets by MSCI. The dependent variable is Log (Equity Flows) the logarithm of portfolio equity inflows from source country to a host country for each year. All variables are as defined in Table A2 of the Appendix. ***, **, * represent statistical significance at 1%, 5 % and 10 % level respectively.

Panel A: Non Recession Year Sample				
Parameters	I	II	III	IV
Source Gini index		0.0845*** (0.004)		
Source Autocratic Country Dummy			-0.9558*** (0.085)	
Sovereign Wealth Fund Dummy				0.7522*** (0.033)
Host Tax Haven	1.3760*** (0.236)	1.2114*** (0.236)	1.2107*** (0.233)	1.3475*** (0.238)
Withholding Taxes (%)	-0.0342*** (0.004)	-0.0442*** (0.005)	-0.0471*** (0.005)	-0.0284*** (0.004)
Log(Source Country GDP per Capita)	0.8090*** (0.019)	1.4334*** (0.036)	1.0124*** (0.023)	0.7508*** (0.019)
Log(Host Country GDP per Capita)	1.4575*** (0.094)	1.5493*** (0.116)	1.6077*** (0.104)	1.4426*** (0.095)
Log(Host Country Market Cap)	0.4573*** (0.024)	0.4985*** (0.033)	0.4841*** (0.027)	0.4664*** (0.025)
Log(Distance)	-0.2309*** (0.026)	-0.4819*** (0.041)	-0.1825*** (0.029)	-0.3873*** (0.027)
Identical Language	0.6724*** (0.057)	0.9415*** (0.088)	0.8132*** (0.054)	0.6619*** (0.058)
Common Law	0.2192* (0.113)	0.3574** (0.158)	0.2263* (0.124)	0.3000** (0.113)
Year Fixed Effects	Yes	Yes	Yes	Yes
No of Observation	13048	6788	12090	13048
R Square	0.9849	0.9884	0.9871	0.9852

Panel B: Non USA host country Sample				
Parameters	I	II	III	IV
Source Gini index		0.0916*** (0.004)		
Source Autocratic Country Dummy			-0.1037*** (0.072)	
Sovereign Wealth Fund Dummy				0.7097*** (0.030)
Host Tax Haven	1.5721*** (0.224)	1.4712*** (0.221)	1.4421*** (0.220)	1.5544*** (0.225)
Withholding Taxes (%)	-0.0257*** (0.004)	-0.0393*** (0.005)	-0.0385*** (0.005)	-0.0202*** (0.004)
Log(Source Country GDP per Capita)	0.7821*** (0.017)	1.4327*** (0.034)	0.9810*** (0.019)	0.7263*** (0.016)
Log(Host Country GDP per Capita)	1.3878*** (0.093)	1.4911*** (0.108)	1.5357*** (0.099)	1.3748*** (0.094)
Log(Host Country Market Cap)	0.4502*** (0.022)	0.4848*** (0.028)	0.4716*** (0.024)	0.4566*** (0.022)
Log(Distance)	-0.2333*** (0.024)	-0.4900*** (0.036)	-0.1791*** (0.027)	-0.3823*** (0.025)
Identical Language	0.8256*** (0.057)	1.1804*** (0.080)	0.9608*** (0.053)	0.8327*** (0.051)
Common Law	0.1042 (0.119)	0.1699 (0.161)	0.0768 (0.127)	0.1679 (0.119)
Year Fixed Effects	Yes	Yes	Yes	Yes
No of Observation	15663	8218	14171	15663
R Square	0.9854	0.9889	0.9874	0.9856

Panel C: MSCI Developed Host Country Capital Markets				
Parameters	I	II	III	IV
Source Gini index		0.0904*** (0.004)		
Source Autocratic Country Dummy			-0.9878*** (0.078)	
Sovereign Wealth Fund Dummy				0.7657*** (0.035)
Host Tax Haven	1.7244*** (0.227)	1.8903*** (0.231)	1.6258*** (0.225)	1.7217*** (0.230)
Withholding Taxes (%)	-0.0391*** (0.005)	-0.0513*** (0.006)	-0.0549*** (0.005)	-0.0332*** (0.004)
Log (Source Country GDP per Capita)	0.8724*** (0.018)	1.6103*** (0.033)	1.0781*** (0.023)	0.8156*** (0.018)
Log(Host Country GDP per Capita)	1.2513*** (0.139)	1.3543*** (0.181)	1.4625*** (0.150)	1.2142*** (0.142)
Log(Host Country Market Cap)	0.5148*** (0.031)	0.6495*** (0.040)	0.5726*** (0.032)	0.5288*** (0.031)
Log(Distance)	-0.1751*** (0.027)	-0.3797*** (0.042)	-0.1233*** (0.030)	-0.3306*** (0.027)
Identical Language	0.6889*** (0.054)	0.9581*** (0.092)	0.8293*** (0.052)	0.6836*** (0.056)
Common Law	0.0948 (0.113)	0.0924 (0.150)	0.0817 (0.119)	0.1681 (0.113)
Year Fixed Effects	Yes	Yes	Yes	Yes
No of Observation	13167	6614	11837	13167
R Square	0.9849	0.9889	0.9874	0.9852

Table A4: Robustness Results- Interaction Model

This tables presents the robustness results with specifications similar to Table 4. In panel A we remove the recession years (2008, 2009) from the sample. In Panel B we remove USA as host country from the sample. In Panel C we have a sample of host countries which are classified as developed capital markets by MSCI. The dependent variable is Log (Equity Flows) the logarithm of portfolio equity inflows from source country to a host country for each year. All variables are as defined in Table A2 of the Appendix. ***, **, * represent statistical significance at 1%, 5 % and 10 % level respectively.

Panel A: Non-Recession Year Sample			
Parameters	I	II	III
Source Gini index	0.0783*** (0.004)		0.0617*** (0.006)
Source Autocratic Country Dummy	-2.8453*** (0.850)	-1.0207*** (0.101)	
Sovereign Wealth Fund Dummy		0.9131*** (0.029)	0.0540 (0.246)
Source Gini index * Source Autocratic Dummy	0.0979*** (0.026)		
Source Autocratic Country Dummy * Sovereign Wealth Fund Dummy		-0.2680*** (0.128)	
Source Gini index * Sovereign Wealth Fund Dummy			0.0177** (0.007)
Host Tax Haven	1.1344*** (0.236)	1.1536*** (0.234)	1.1967*** (0.239)
Withholding Taxes (%)	-0.0424*** (0.005)	-0.0428*** (0.005)	-0.0419*** (0.005)
Log(Source Country GDP per Capita)	1.5030*** (0.042)	0.9380*** (0.022)	1.3836*** (0.037)
Log(Host Country GDP per Capita)	1.6011*** (0.114)	1.5936*** (0.105)	1.5401*** (0.117)
Log(Host Country Market Cap)	0.5017*** (0.034)	0.4973*** (0.028)	0.5072*** (0.033)
Log(Distance)	-0.4709*** (0.042)	-0.3714*** (0.029)	-0.5588*** (0.043)
Identical Language	0.8641*** (0.090)	0.7898*** (0.057)	0.9768*** (0.089)
Common Law	0.3837* (0.161)	0.3427** (0.123)	0.4052** (0.159)
Year Fixed Effects	Yes	Yes	Yes
No of Observation	6633	12090	6788
R Square	0.9890	0.9875	0.9887

Panel B: Non-USA Host Country Sample			
Parameters	I	II	III
Source Gini index	0.0871*** (0.004)		0.0821*** (0.005)
Source Autocratic Country Dummy	-3.6360*** (0.741)	-1.0704*** (0.098)	
Sovereign Wealth Fund Dummy		0.8971*** (0.027)	0.7796*** (0.158)
Source Gini index * Source Autocratic Dummy	0.1227*** (0.022)		
Source Autocratic Country Dummy * Sovereign Wealth Fund Dummy		-0.3085*** (0.126)	
Source Gini index * Sovereign Wealth Fund Dummy			-0.0035 (0.004)
Host Tax Haven	1.4188*** (0.222)	1.3998*** (0.221)	1.4750*** (0.222)
Withholding Taxes (%)	-0.0370*** (0.004)	-0.0346*** (0.005)	-0.0376*** (0.005)
Log(Source Country GDP per Capita)	1.5034*** (0.038)	0.9079*** (0.019)	1.3877*** (0.034)
Log(Host Country GDP per Capita)	1.5371*** (0.108)	1.5203*** (0.101)	1.4782*** (0.109)
Log(Host Country Market Cap)	0.4866*** (0.029)	0.4819*** (0.025)	0.4926*** (0.029)
Log(Distance)	-0.4808*** (0.037)	-0.3656*** (0.027)	-0.5678*** (0.038)
Identical Language	1.1607*** (0.082)	0.9584*** (0.052)	1.2009*** (0.082)
Common Law	0.1750 (0.167)	0.1720 (0.125)	0.2112 (0.161)
Year Fixed Effects	Yes	Yes	Yes
No of Observation	8055	14171	8218
R Square	0.9890	0.9878	0.9891

Panel C: MSCI Developed Host Country Capital Markets			
Parameters	I	II	II
Source Gini index	0.0853*** (0.005)		0.0730*** (0.008)
Source Autocratic Country Dummy	-4.7955*** (0.811)	-0.8914*** (0.096)	
Sovereign Wealth Fund Dummy		0.9603*** (0.029)	0.4650* (0.281)
Source Gini index * Source Autocratic Dummy	0.1633*** (0.025)		
Source Autocratic Country Dummy * Sovereign Wealth Fund Dummy		-0.5257*** (0.126)	
Source Gini index * Sovereign Wealth Fund Dummy			0.0067 (0.007)
Host Tax Haven	1.8511*** (0.233)	1.5927*** (0.226)	1.9068*** (0.234)
Withholding Taxes (%)	-0.0463*** (0.006)	-0.0522*** (0.005)	-0.0501*** (0.006)
Log(Source Country GDP per Capita)	1.7219*** (0.037)	1.0070*** (0.021)	1.5653*** (0.033)
Log(Host Country GDP per Capita)	1.4741*** (0.176)	1.4216*** (0.153)	1.3264*** (0.184)
Log(Host Country Market Cap)	0.6636*** (0.039)	0.5921*** (0.033)	0.6615*** (0.040)
Log(Distance)	-0.3606*** (0.041)	-0.3104*** (0.029)	-0.4486*** (0.042)
Identical Language	0.08542*** (0.096)	0.8052*** (0.056)	1.0001*** (0.089)
Common Law	0.0990 (0.154)	0.1888 (0.118)	0.1295 (0.150)
Year Fixed Effects	Yes	Yes	Yes
No of Observation	6474	11837	6614
R Square	0.9889	0.9879	0.9893

Table A5: Robustness Results - Tax Havens Model

This tables presents the robustness results with specifications similar to Table 5. In panel A we remove the recession years (2008, 2009) from the sample. In Panel B we remove USA as host country from the sample. In Panel C we have a sample of host countries which are classified as developed capital markets by MSCI. The dependent variable is Log (Equity Flows) the logarithm of portfolio equity inflows from source country to a host country for each year. All variables are as defined in Table A2 of the Appendix. ***, **, * represent statistical significance at 1%, 5 % and 10 % level respectively.

Panel A: Non-Recession Year Sample			
Parameters	I	II	III
Source Gini index	0.0855*** (0.004)		
Sovereign Wealth Fund Dummy		0.7517*** (0.033)	
Source Autocratic Country Dummy			-0.9780*** (0.087)
Source Gini index * Host Tax Haven	-0.0335** (0.014)		
Sovereign Wealth Fund Dummy * Host Tax Haven		-0.0150 (0.102)	
Source Autocratic Country Dummy * Host Tax Haven			0.7662*** (0.250)
Host Tax Haven	2.4479*** (0.521)	1.3413*** (0.237)	1.1495*** (0.233)
Withholding Taxes (%)	-0.0437*** (0.005)	-0.0284*** (0.004)	-0.0471*** (0.005)
Log(Source Country GDP per Capita)	1.4331*** (0.036)	0.7508*** (0.019)	1.0128*** (0.023)
Log(Host Country GDP per Capita)	1.5485*** (0.115)	1.4426*** (0.095)	1.6087*** (0.103)
Log(Host Country Market Cap)	0.4974*** (0.033)	0.4664*** (0.095)	0.4845*** (0.027)
Log(Distance)	-0.4804*** (0.042)	-0.3873*** (0.026)	-0.1827*** (0.029)
Identical Language	0.9409*** (0.089)	0.6619*** (0.058)	0.8088*** (0.054)
Common Law	0.3580** (0.158)	0.3001*** (0.113)	0.2273* (0.124)
Year Fixed Effects	Yes	Yes	Yes
No of Observation	6788	13048	12090
R Square	0.9884	0.9852	0.9869

Panel B: Non-USA Host Country Sample			
Parameters	I	II	III
Source Gini index	0.0927*** (0.004)		
Sovereign Wealth Fund Dummy		0.7082*** (0.031)	
Source Autocratic Country Dummy			-1.0585*** (0.074)
Source Gini index * Host Tax Haven	-0.0354** (0.014)		
Sovereign Wealth Fund Dummy * Host Tax Haven		-0.0476 (0.108)	
Source Autocratic Country Dummy * Host Tax Haven			0.7739*** (0.221)
Host Tax Haven	2.7622*** (0.512)	1.5351*** (0.225)	1.3822*** (0.219)
Withholding Taxes (%)	-0.0387*** (0.005)	-0.0202*** (0.004)	-0.0386*** (0.005)
Log(Source Country GDP per Capita)	1.4320*** (0.034)	0.7263*** (0.016)	0.9815*** (0.019)
Log(Host Country GDP per Capita)	1.4901*** (0.108)	1.3748*** (0.094)	1.5366*** (0.100)
Log(Host Country Market Cap)	0.4838*** (0.028)	0.4566*** (0.022)	0.4720*** (0.024)
Log(Distance)	-0.4890*** (0.037)	-0.3823*** (0.025)	-0.1792*** (0.027)
Identical Language	1.1831*** (0.080)	0.8326*** (0.051)	0.9532*** (0.053)
Common Law	0.1709 (0.161)	0.1680 (0.119)	0.0778 (0.127)
Year Fixed Effects	Yes	Yes	Yes
No of Observation	8218	15663	14171
R Square	0.9889	0.9856	0.9874

Panel C: MSCI Developed Host Country Capital Markets			
Parameters	I	II	III
Source Gini index	0.0912*** (0.004)		
Sovereign Wealth Fund Dummy		0.7690*** (0.036)	
Source Autocratic Country Dummy			-1.0137*** (0.080)
Source Gini index * Host Tax Haven	-0.0244* (0.015)		
Sovereign Wealth Fund Dummy * Host Tax Haven		-0.0867 (0.106)	
Source Autocratic Country Dummy * Host Tax Haven			0.8608*** (0.240)
Host Tax Haven	2.7807*** (0.532)	1.7570*** (0.231)	1.5598*** (0.225)
Withholding Taxes (%)	-0.0510*** (0.006)	-0.0332*** (0.004)	-0.0549*** (0.005)
Log(Source Country GDP per Capita)	1.6102*** (0.033)	0.8156*** (0.018)	1.0786*** (0.023)
Log(Host Country GDP per Capita)	1.3539*** (0.181)	1.2145*** (0.143)	1.4622*** (0.149)
Log(Host Country Market Cap)	0.6488*** (0.040)	0.5287*** (0.031)	0.5732*** (0.032)
Log(Distance)	-0.3781*** (0.042)	-0.3303*** (0.027)	-0.1238*** (0.030)
Identical Language	0.9587*** (0.092)	0.6838*** (0.056)	0.8242*** (0.052)
Common Law	0.0918 (0.150)	0.1678 (0.113)	0.0828 (0.119)
Year Fixed Effects	Yes	Yes	Yes
No of Observation	6614	13167	11837
R Square	0.9891 [^]	0.9852	0.9874