When greener is more attractive: environmental factors and capital flows to emerging markets

Jose Aurazo, Rafael Guerra, Pablo Tomasini, Alexandre Tombini and Christian Upper[1]

Abstract

We study the impact of environmental factors on international capital flows (ie portfolio, bank and FDI inflows) to emerging market economies (EMEs). We use two approaches. First, we look at the importance of receiving country factors using quarterly panel data for 19 EMEs that countries more exposed to extreme weather events and with less green energy mix, fewer climate-related policies and a lower share of firms reporting emissions tend to receive less foreign capital than others. Our second approach uses annual bilateral data on FDI and looks at how sending country factors as well as their interaction with receiving country variables affect capital flows. It largely confirms the results of the receiving country estimations, although the sign of the variables related to receiving country variables flips once one controls for sending country factors. In particular, tighter environmental regulations and reporting standards are associated with lower rather than higher FDI, at least in the short term. The estimations with bilateral data also show important interactions between receiving and sending country characteristics. For instance, environmental policies in the receiving country matter more for flows from countries that have also enacted tight policies.

Keywords: environmental factors, capital flows, emerging markets, energy mix.

JEL classification: F21, F23, F64.

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1. Introduction

Environmental considerations – covering climate-related issues, pollution and the destruction of habitats – are likely to play a growing role in public and private sector capital allocation in the coming years.[2] Some activities will become more expensive or simply unfeasible whereas others will gain importance. This will change the risk-return profile of many assets, which should affect capital allocation both within and between countries.

This paper aims to answer how environmental factors related to physical and transition risks[3] affect capital flows to EMEs. We undertake two empirical exercises. The first focuses on the receiving country, where we regress different types of capital inflows (portfolio investment, bank lending and FDI inflows) on our environmental variable of choice, domestic pull factors as controls and a full set of time fixed effects to control for push factors common across destination countries. We do this for a panel of 19 EMEs ranging from 2010 to 2023.

Panel local projections à la Jordà (2005) suggest that countries with more extreme weather events, a less green energy mix, fewer climate-related policies and a lower share of firms reporting emissions receive less foreign capital than others. The results vary across type of flows. Extreme weather events reduce FDI but have no discernible impact on portfolio investment or bank lending. A greener energy mix boosts FDI and portfolio investment but does not affect cross-border bank lending. More climate-related policies in the receiving country are associated with higher FDI and portfolio investment but have no apparent effect on bank flows. Finally, a higher share of firms reporting emissions affects portfolio investment and cross-border bank lending but not FDI. Some of the results also vary over time. While the impact of physical risk on foreign investment holds for the entire sample, a green energy mix only has a positive impact on flows after the Paris Agreement came into effect in 2016. This is no surprise, because the agreement was the first in which EMEs committed to reducing emissions.

Our second approach looks at how sending country factors as well as their interaction with receiving country variables affect capital flows. We regress bilateral flows from [xx] sending countries to 21 EMEs on sending and receiving country variables of interest as well as their interactions plus a full set of country and time

[2] We believe that the growing backlash in recent years will not change this in any material way since the underlying forces (climate change, habitat destruction, pollution) and their economic and social consequences will remain in place.

[3] **Physical risk** refers to the potential for damage and disruption caused by extreme weather events and other climate-related phenomena. This risk can lead to substantial economic and infrastructural damage, making these markets less attractive to investors due to heightened uncertainty and potential losses. **Transition risk** is associated with the process of adjusting to a lower-carbon economy. These risks emerge from increased awareness of climate change and the subsequent political and regulatory actions taken to mitigate its effects. Transition risks, arising from increased climate awareness and regulatory changes, can alter investment patterns as capital shifts towards more sustainable and low-carbon opportunities. This reallocation can result in reduced capital inflows to emerging markets that are perceived as lagging in climate adaptation and mitigation efforts, thereby affecting their economic growth and development prospects.

fixed effects. Since bilateral portfolio investment data is distorted by the routing of flows through financial centres, we are only able to obtain reliable estimates for FDI.[4]

[results]

To the best of our knowledge, this is the first paper to consider how environmental factors and regulations in both the sending and receiving country affect capital flows to EMEs. Previous papers limit their analysis to FDI or bank lending and consider fewer or different environmental variables.[5] Furthermore, we go deeper into mechanisms through which these factors may influence and adjust capital inflows to EMEs. [6]

Gu and Hale (2023) and Pienknagura (2024), which explore how environmental factors affect FDI. Gu and Hale estimate whether FDI reacts to physical and transition risks at different levels of aggregation as well as at the firm level for both advanced economies (AEs) and emerging market economies (EMEs). They do not find much impact of either the number of extreme weather events or climate change policies (as proxies for physical and transition risk, respectively) in the aggregate data, although they do obtain some significance at more granular levels and after the Paris Agreement accord. Pienknagura reports that climate policies in the recipient country can boost "green" FDI in a large sample of countries, especially in EMEs, while having virtually no effect on the remaining "brown" inflows. There is also a larger literature on how climate policies in the source country affect FDI.[7]

There is a larger literature on bank lending, although the evidence is mixed (Aiello (2024), Degryse et al. (2023), Demetriades and Politsidis (2025), Erten and Ongena (2023), and Gambacorta et al. (2023), Sastri, Verner and Marquez-Ibanez (2024)). Additionally, Kacperczyk and Peydró (2022) found that banks lend less to firms with high carbon emissions but are more willing to lend to high-emission firms with ambitious reduction targets.

The paper is structured as follows. Section 2 discusses the potential mechanisms through which environmental factors may affect capital flows. Section 3 presents our empirical strategy and econometric specifications. In Section 4, we present the data. We present our results in section 5. A final section concludes.

[4] In future work, we would also like to study bank flows.

[5] We have not found any papers that discuss the effect of environmental factors on portfolio investment.

[6] There is also a large literature finding that such policies affect asset prices. The surveys by Eren et al (2022) and De Bandt (2023) find evidence for financial markets and banks pricing climate-related risks. That said, the size of the price effects (*greenium*) is generally quite small and, given the absence of accepted benchmarks it is unclear whether it does capture the full amount of risk. Gormsen et al (2024) show that firms' *perceived cost of capital* extracted from earning calls was about one percentage point lower for "green" than for "brown" firms.[6] This discrepancy had real effects, as firms that perceived this differential as being large pledged larger emission reductions than those that believed that it was small. Some large firms also used lower discount rates for their green than their brown operations.

[7] Ben David et al (2021) and Koch and Mama (2019) find some evidence of leakage from the European Union's Emissions Trading System, although the magnitudes are relatively limited.

2. Potential mechanisms

Environmental factors can affect capital flows through a variety of channels. First, physical risks and environmental degradation may damage assets, increase costs, or render some activities less profitable, thereby deterring investment. Second, policies and regulations intended to address environmental degradation and climate change can significantly influence capital flows. Stricter environmental regulations may increase compliance costs for businesses, potentially reducing their attractiveness to investors, while supportive policies such as subsidies for renewable energy can attract investment into green technologies. Finally, a possible preferences for green energies (perhaps aligned with global energy transition goals) create another channel, as the growing demand for environmentally responsible investments drives capital towards sustainable sectors and projects.

2.1 Physical risks channel

The globe is warming, and extreme weather events are becoming more common (Graph 1.A). Many EMEs, especially in Asia and Latin America, are strongly exposed to physical risks. For example, many Asian economic centres are close to the coast and prone to flooding. Building dykes or relocating activities will increase production costs and may not always be feasible. Most EMEs are in the hot regions of the globe, so further increases in temperatures can lower agricultural yields, increase cooling costs and reduce productivity of outdoor activities (Graph 1.B). At the same time, environmental degradation and physical risk may spur the demand for some goods and services. Global warming may also benefit some regions, even if the global effects are negative.

Physical risks can affect foreign investment in at least two ways. First, it could boost FDI if firms rebuild destroyed capital or undertake investment to increase the resilience of existing capital. Similarly, it may boost portfolio or bank lending as domestic firms or the government borrow abroad to finance rebuilding. Second, an increase in the number of extreme weather events may discourage future investment and thus inflows. Both effects offset each other, so it becomes an empirical issue which one dominates.

2.2 Environmental regulation channel

Climate-related policies have gained importance, initially in advanced economies (AEs) but increasingly also in emerging market economies (EMEs) (Graph 2.A). These policies come in a wide variety of forms, ranging from outright prohibitions of certain activities to quantity ceilings or taxes on certain emissions, and emissions reporting requirements. In this paper, we will focus on climate-related policies in general and on the reporting of CO2 emissions by firms.[8]

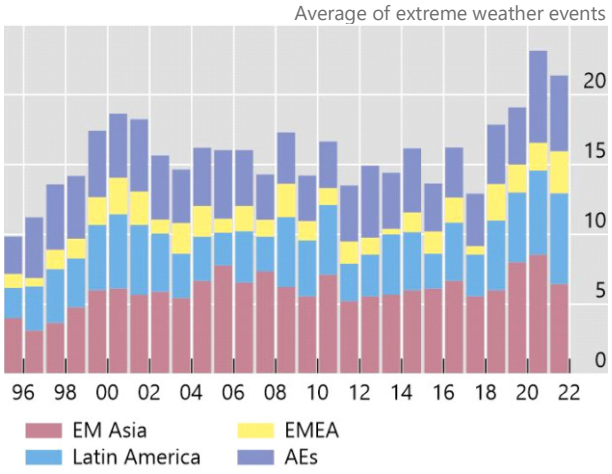
[8] We will focus on the reporting of direct greenhouse gas emissions and indirect emissions from the use of purchased energy by firms, commonly referred to as scope 2 emissions. Scope 3 emissions, the broadest category, include indirect emissions that occur along the value chain and are outside

In contrast to the immediate impact of physical risks, we would expect the effects of environmental policies to become relevant only quite recently, especially in the case of policies aimed at combating climate change. Advanced economies committed to reducing greenhouse gas emissions in the Kyoto Protocol of 2005. That said, such policies only became widespread after the Paris Agreement, which entails much more wide-ranging commitments, came into force in 2016. Unlike the Kyoto Protocol, the Paris Agreement also included significant commitments from EMEs to reduce greenhouse gas emissions, leading to the adoption of more environmental policies by these countries. However, there could also be negative effects arising from higher regulation, which pushes this work into the empirical field.

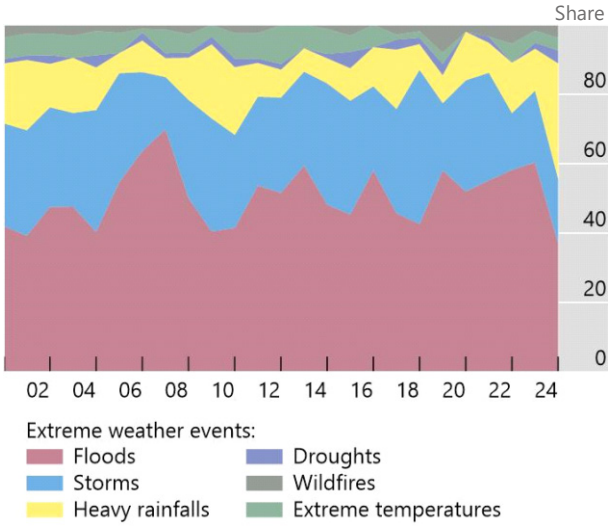
Physical risks have become more important

Graph 1

A. Extreme weather events become more common[1]



B. Floods, storms, and heavy rainfall dominate the extreme weather events



[1] Climatological, hydrological and meteorological events that caused ten or more deaths.

Sources: CRED, EM-DAT; BIS.

The impact of environmental policies and reporting standards on capital flows to the *receiving* country is ambiguous. On the one hand, more regulation could reduce risk and serve as a seal of approval, thus helping attract capital inflows. On the other hand, it could increase the costs of doing business and thus deter foreign investment.

Regulation in the sending countries could also influence capital flows, often in interaction with policies in the receiving country. We consider two opposing mechanisms. In the first, firms in sending countries with stricter standards may offshore dirty activities to EMEs with laxer policies (emission shifting). In the second, investors in sending countries with higher regulation may prefer to invest in countries with a minimum level of green regulation.

This leads to the following testable hypotheses:

the organization's direct control. Most firms report scope 2 emissions. Data on scope 3 emissions is much sparser and mainly based on estimates by consultants rather than direct reporting.

- Higher environmental regulation in the receiving countries boosts foreign investment (seal of approval).
- Higher environmental regulation in the receiving countries dampens foreign investment (cost of doing business).
- Higher regulation in sending countries boost foreign investment to EMEs with high levels of green regulation more than to EMEs with low levels of green regulation (seal of approval).
- Higher regulation in sending countries boosts foreign investment inflows to EMEs with low levels of green regulation more than to EMEs with high levels of green regulation (emission shifting mechanism).

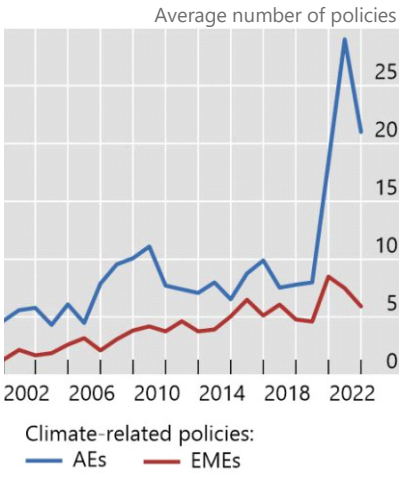
2.3 Greenness of the energy mix

The Kyoto and Paris agreements were also followed by a sharp rise in the share of renewables in the energy mix of AEs and EMEs, respectively. Since Paris, the share of renewables in electricity generation in EMEs rose by some five percentage points to 27%, although this remains considerably below the 50% achieved in AEs (Graph 2.C).

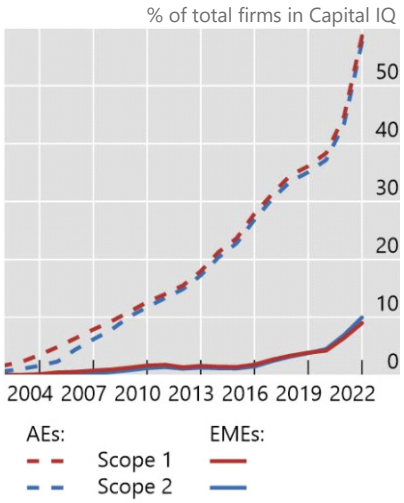
A higher share of energy generated from renewables in the receiving country could help attract capital in the destination country since it would allow foreign investors or lenders meet potential emission goals. We would expect this effect to be stronger for sending countries with high levels of environmental regulation than those with low regulation, or a with a high number of firms reporting emissions or, for portfolio investment, a larger presence of investors following environmental goals.

Environmental regulation and green energy mix gain ground Graph 2

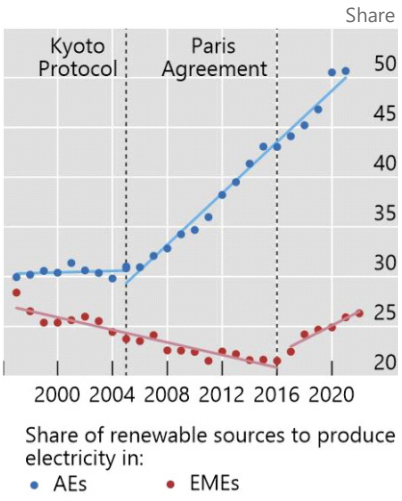
A. Environmental policies gain importance[1]



B. More firms are reporting greenhouse gas emissions



C. Share of renewables rising[2]



[1] Policies in force or announced since 2000. [2] Simple mean across AEs and EMEs.

Sources: IEA; Capital IQ; BIS.

3. Empirical strategy

We test for the impact of environmental factors on capital flows using two methodologies. The first focuses on how *recipient* country factors affect capital to EMEs. Since the drivers are likely to vary across types of flows, we estimate separate regressions for portfolio investment, bank lending and FDI. The second approach focuses on the interaction of *receiving* and *sending* country factors and uses data on bilateral FDI. Since bilateral portfolio investment data is distorted by the routing of flows through financial centres, we are only able to obtain reliable estimates for FDI.[9]

3.1 A receiving country approach

To delve deeper into how changes in physical and transitions risks may influence capital flows, we draw on the literature relating capital flows to EMEs to push and pull factors. In a comprehensive literature review on the determinants of capital flows, Koepke (2019) identifies four common areas as pull factors: i) the growth of the real sector, ii) risk premia and risk aversion, iii) the level and spread of policy rates, and iv) country risk. Based on these findings, we follow Aguilar et al (2025) to include a vector of domestic variables to control for key pull factors. We limit this set of variables to maintain a parsimonious model while incorporating our green pull factor variable of interest. We control for all types of push factors through a full set of time fixed effects. Finally, we employ local panel projections (Jordà, 2005) for 21 EMEs to assess the

[9] In future work, we would also like to study bank flows.

statistical significance of the quarterly projections following the impact. We estimate the following equation:

$$Y_{i,t+h} = \beta^h Y_{i,t-1} + env_{i,t} + \sum_{j=1}^{4} \gamma_j^h Domestic\ controls_{i,t-j} + \alpha_t + \alpha_i + \varepsilon_{i,t+h} \quad (1)$$

where $Y_{i,t+h}$ are gross capital inflows to country *i* (portfolio, bank or FDI) over the next *h = 0…8* quarters; $Y_{i,t-1}$ is the lag of the dependent variable. $env_{i,t}$ is our variable of interest, namely the growth rate of extreme weather events, climate-related policies, firm reporting carbon emission and the share of green energy to produce electricity. We also include a vector $Domestic\ controls_{it-j}$ to control for country-specific (pull) factors. It includes four lags of the policy rate, government debt as percentage of GDP, short-term GDP growth expectations and domestic equity volatility. Time fixed effects (α_t) control for global (push) factors and common events across countries (eg movements in international prices of oil and gas) and country fixed effects (α_i) for time-invariant country characteristics.[10] We report Driscoll and Kraay standard errors, accounting for cross-sectional dependence.

This approach is conducted at a quarterly frequency for 19 EMEs: Argentina, Brazil, Chile, China, Colombia, Hong Kong, India, Indonesia, Malaysia, Mexico, Peru, the Philippines, Poland, Saudi Arabia, South Africa, South Korea, Thailand, Türkiye, and Vietnam.

3.2 Receiving-sending country approach

The receiving country methodology can tell us how *receiving* country factors affect capital flows but it does not allow us to gauge the impact of home country factor, for instance environmental policies or reporting requirements. We therefore complement it the receiving country approach with a receiving-sending country model that uses bilateral data on FDI inflows. We estimate the following regression:

$$y_{i,j,t+h} = y_{t-1} + \alpha_1^h env_{i,t} + \alpha_2^h env_{j,t} + \alpha_3^h env_{i,t} * env_{j,t} + \beta_h' X_{i,t} + \emptyset_h' X_{j,t} + \theta_i + \gamma_j + \delta_t + \varepsilon_{i,j,t+h} \quad (2)$$

where $y_{i,j,t}$ are FDI inflows from sending country *j* to receiving country *i* in period *t*. $policy_{i,t}$, $env_{i,t}$ and $env_{j,t}$ define the environmental factor in receiving country *i* and

[10] When testing the use of green energy to produce electricity variable, we include as a control the share of nuclear energy to produce electricity as a control variable. The coefficients of these shares should be interpreted relative to the use of fossil sources (these three shares sum up to 100).

sending country j in year t and $env_{i,t} * env_{j,t}$ their interaction. $X_{i,t}$ and $X_{j,t}$ are controls for push and pull factors in sending and receiving countries in year t. θ_i, γ_j and δ_t refer to sending-country, receiving-country and time-fixed effects. $\varepsilon_{i,j,t}$ is the error term.

3. Data

Our sample comprises 21 EMEs.[11] The data spans from Q1 1996 to Q3 2023, though the sample analysis will vary as necessary. We use the full sample for physical risks but a version restricted to the year 2016-2023 for environmental policies and green energy, which are unlikely to have affected capital flows before the Paris Agreement came into effect in 2016. We use alternative sample splits as a robustness exercise.

a. Environmental factors considered

We focused on the following data to analyse how environmental factors could affect capital flows to EMEs:

- Extreme weather events: Data is from the EM-DAT, The International Disaster Database. Following the methodology of Gu and Hale (2023), an extreme weather event is defined as one that results in ten or more fatalities in the receiving country.
- The share of renewable, brown and nuclear energy in electricity production (source: International Energy Agency).
- Climate-related policies: data is from the policies database reported by the International Energy Agency (IEA). This database encompasses a comprehensive set of categories, including the description of the policy, the year of implementation, status, and jurisdiction.
- Climate-related policies: we used the policies database reported in the IEA. This database contains a rich set of categories related to the description of the policy, the year of implementation, status and jurisdiction.
- Greenhouse Gas Emissions (Scope 1): data is from S&P Global Market Intelligence, which reports on the emissions of a representative sample of firms in each country that comply with green regulations by disclosing their greenhouse gas emissions.

b. Macroeconomic and financial variables

We use capital flows data from the IMF Balance of Payments. Non-resident portfolio investment in EMEs is defined as the sum of debt and equity portfolio investments.

[11] Argentina, Brazil, Chile, China, Colombia, Hong Kong, India, Indonesia, Korea, Malaysia, Mexico, Peru, the Philippines, Poland, Saudi Arabia, Singapore, South Africa, Thailand, Türkiye, United Arab Emirates and Vietnam.

Additionally, we consider foreign direct investment (FDI) flows, and we define the category of other flows as a proxy for cross-border bank loans to EMEs, which constitute the majority of investment flows within this residual category.

For our vector of macroeconomic and financial domestic variables implemented in our baseline regressions, we use national data sources for the policy rate. Government debt levels (as a percentage of GDP) are sourced from the IMF World Economic Outlook. GDP growth expectations are derived from private sector surveys conducted by Consensus Economics. For the equity volatility variable, we utilise data from Bloomberg.

Summary table 1 shows the main descriptive statistics of the mentioned data.

Summary statistics

Table 1

	Observations	Mean	Std dev	Min	Max
Extreme weather events (# events)	2,000	3.4	4.6	0	26
Use of renewable energy to produce electricity (%)	2,296	25.2	25.8	0	93.6
Use of brown energy to produce electricity (%)	2,296	72.1	25.5	5.6	100
Use of nuclear energy to produce electricity (%)	2,296	2.7	7.1	1	42.7
Climate-related policies implemented (# policies)	1,808	4.8	4.7	1	29
Greenhouse gas emissions reported (# firms)	1,704	175.9	395.3	-57.3	3,698
Portfolio flows (% of GDP)	1,764	1.6	5.1	-246.7	70.3
Bank flows (% of GDP)	2,053	2.2	17.4	-17.9	207.8
FDI flows (% of GDP)	2,061	4.8	8.5	0.2	99.8
Nominal monetary policy rate (%)	2,189	7.3	9.4	0.5	126.18
Government debt (% of GDP)	2,296	45.8	27.4	-9.3	177.2
One-year-ahead GDP growth expectations (%)	2,320	4.0	2.4	-9.3	10.8
Equity volatility (std)	2,131	1.3	0.8	0.3	6.1

Source: Authors' calculations.

4. Results

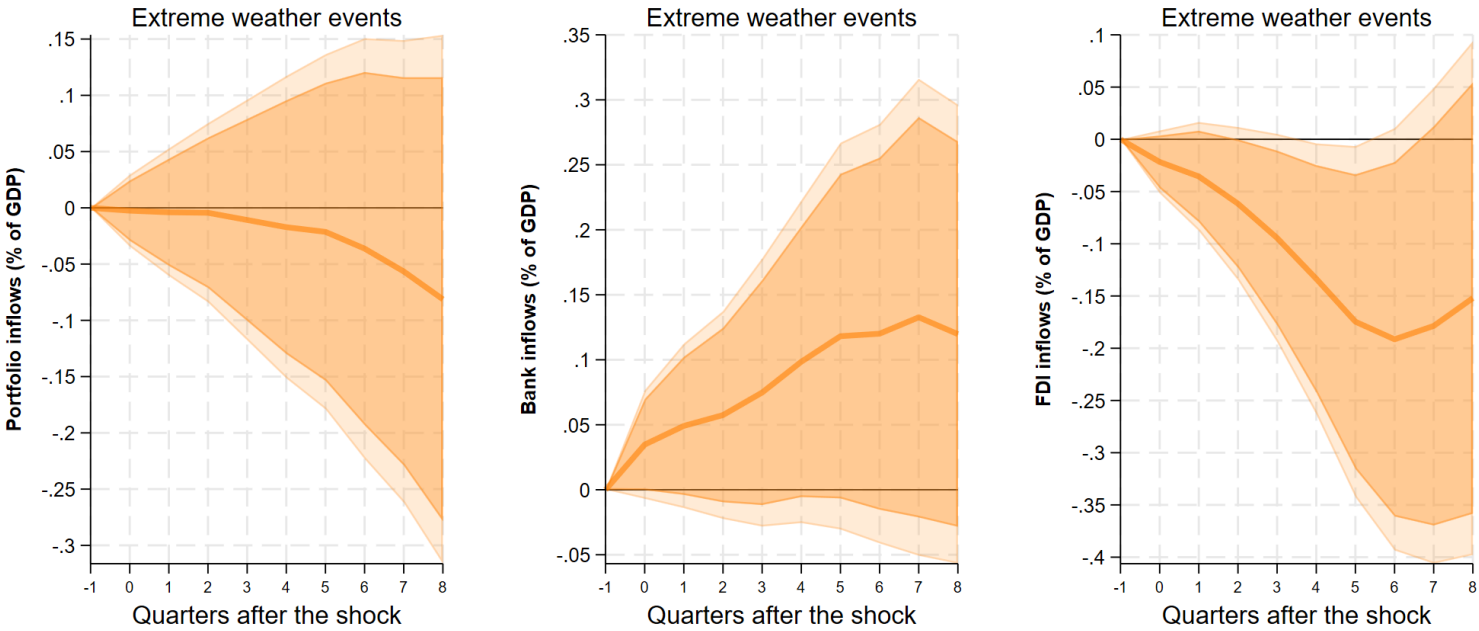
This section presents the results for both approaches. We have divided our findings into two parts: i) results related to a panel approach with gross capital inflows to EMEs (receiving countries), and ii) results related to paired bilateral flows from advanced economies (AEs) to EMEs (sending-receiving country approach).

5.1 Receiving country approach

5.1.1 Physical risks

We find evidence that physical risk in the receiving country matters for FDI but not for portfolio investment or bank lending. An increase in extreme weather events can reduce FDI inflows to EMEs but has not statistically significant effect on portfolio or bank flows (Graph 3). A 10% increase in the number of extreme weather events in the receiving country indicates is associated with a 0.18% of GDP drop in FDI inflows after six quarters.

Graph 3. Physical risk matters for FDI but not for other inflows.



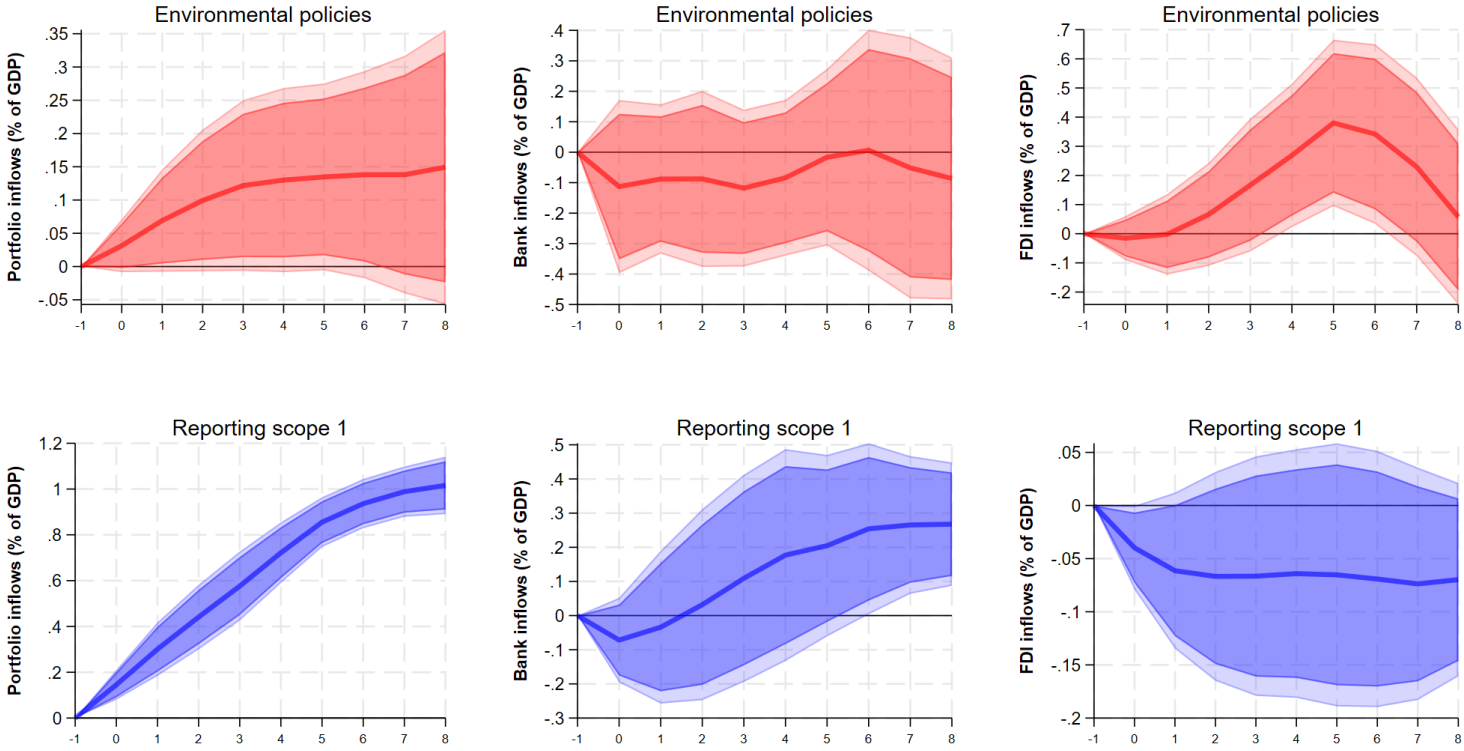
Note: Impact of 10% increase of extreme weather events on capital inflows to EMEs. Panel local projections for 19 EMEs from 2010 to 2024. Light area: Confidence intervals at 95%; dark area: confidence intervals at 90%. Driscoll-Kraay standard errors.

5.1.2 Environmental regulation

An increase in the number of environmental policies in the receiving country appears to have a positive impact on FDI and, to a lesser extent, portfolio investment but not bank flows. A 10% increase in the annual growth rate of the number of green policies implemented goes hand-in-hand with an 1.5% increase in portfolio and 4% rise in FDI inflows, respectively (Graph 4, upper panels). By contrast, we don't find any significant effect on bank flows. On its own, this tilts the evidence in favour of the "seal of approval" hypothesis, in which more stringent policies in the receiving country result in higher inflows, and against the "emission shifting" hypothesis according to which EMEs can attract capital flows through lax environmental standards.

A higher share of receiving countries reporting emissions is associated with higher portfolio inflows and bank inflows but not FDI (Graph 4, bottom panels). This could reflect portfolio flows and bank lending going to non-affiliated firms. By contrast, the emissions of direct affiliates need to be reported anyway by the parent company, even if not mandated by recipient country regulations.

Graph 4. Overall, environmental regulation in the receiving country is associated with higher capital inflows to EMEs.



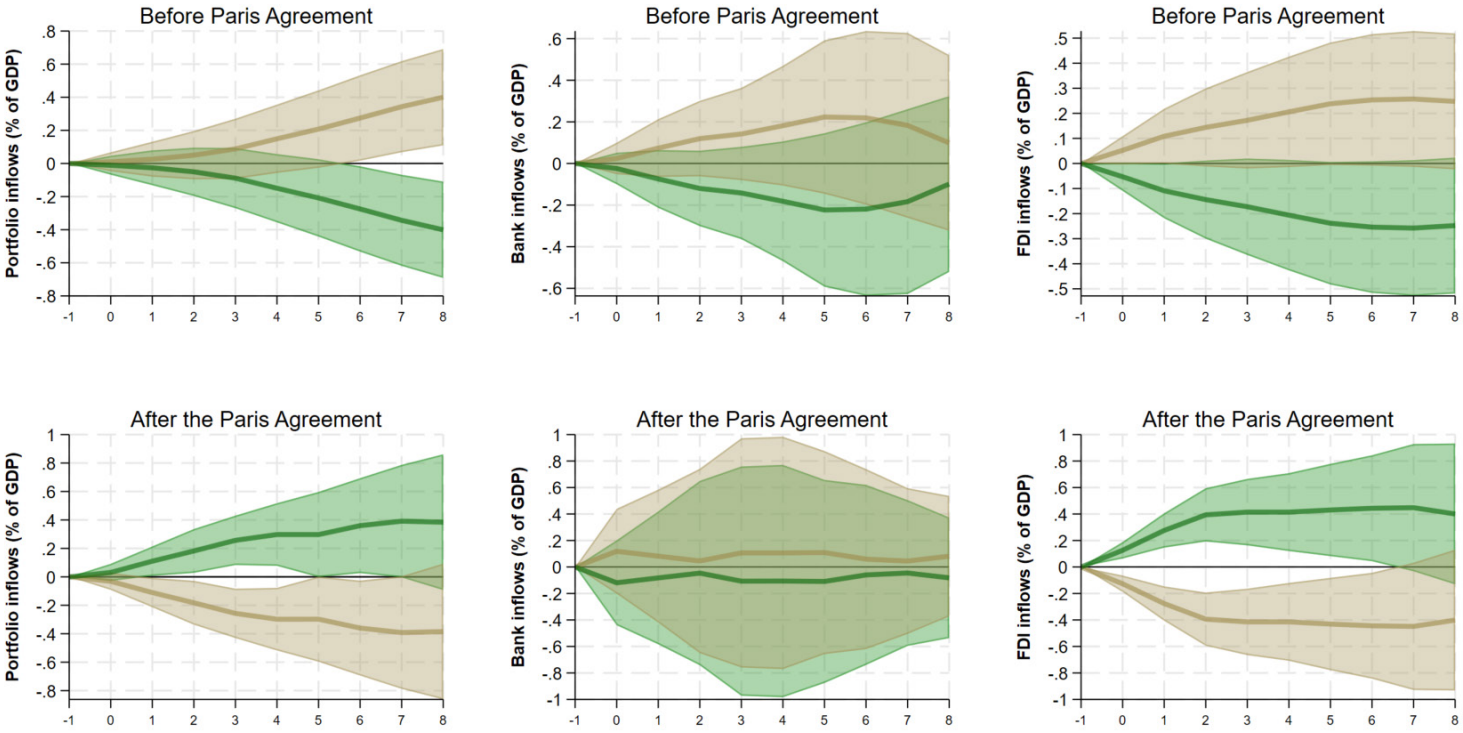
Note: In red: Impact of 10% increase of climate-related policies on capital inflows to EMEs. In blue: Impact of 10% increase of firms reporting scope1 on capital inflows to EMEs. Panel local projections for 19 EMEs from 2016 to 2024. Light area: confidence intervals at 95%; dark area: confidence intervals at 90%. Driscoll-Kraay standard errors.

5.1.2 Energy mix

The final environmental factor to test is the use of green energy to produce electricity. We find that a higher share of green energy is associated with greater portfolio and FDI inflows relative to the use of fossil energies (green lines in Graph 5). A 1 percentage point (pp) shift in electricity production from fossil fuels to renewables tends to be followed by a cumulative increase in both portfolio and FDI inflows of up to 0.4 pp of GDP in the following quarters. Prior to the Paris Agreement, this relationship was negative (brown lines). For, bank flows, the effect is not statistically significant either before or after the Paris agreement.[12]

[12] This is in line with mixed evidence on how banks are considering environmental issues in their lending. In the euro area, that some banks appear to factor them into their lending decisions, but others do not. See Aiello (2024), Degryse et al (2023), Erten and Ongena (2023) and Gambacorta et al (2023). Kacperczyk and Peydró (2022) find that while banks reduce lending to firms with high carbon emissions, they do not lend to high-emissions firms with ambitious carbon reduction targets, perhaps because of their limited credibility.

Graph 5. A rising share of renewable energy is associated with higher portfolio and FDI inflows after the Paris Agreement.

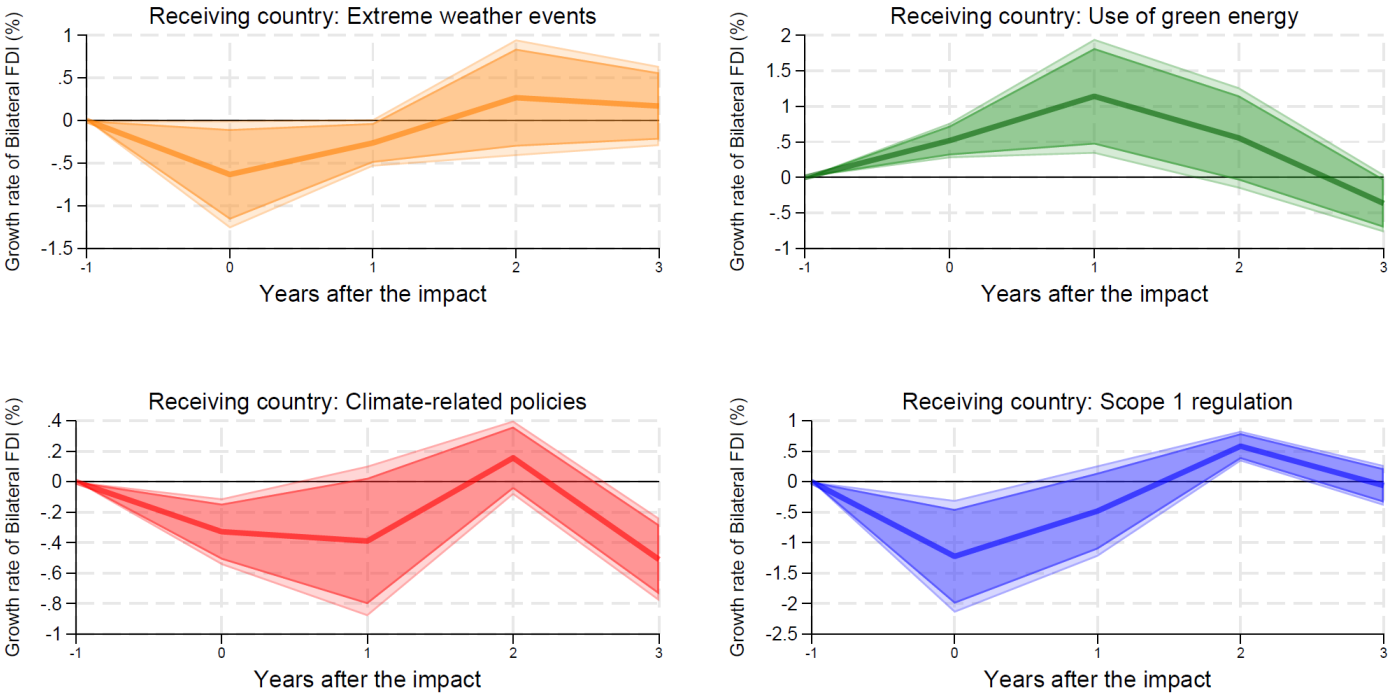


Note: In green: Impact of 1% increase of renewable energy use on capital inflows to EMEs. In brown: Impact of 1% increase of fossil energy use on capital inflows to EMEs. Panel local projections for 19 EMEs. Before Paris Agreement: 2000-15; after Paris Agreement: 2016-2024. Confidence intervals at 95. Driscoll-Kraay standard errors.

Gormsen et al (2024) also find a break around 2016. Before, firms did not discern any differences in the cost of capital whereas afterwards they didn't.

5.2 Bilateral approach

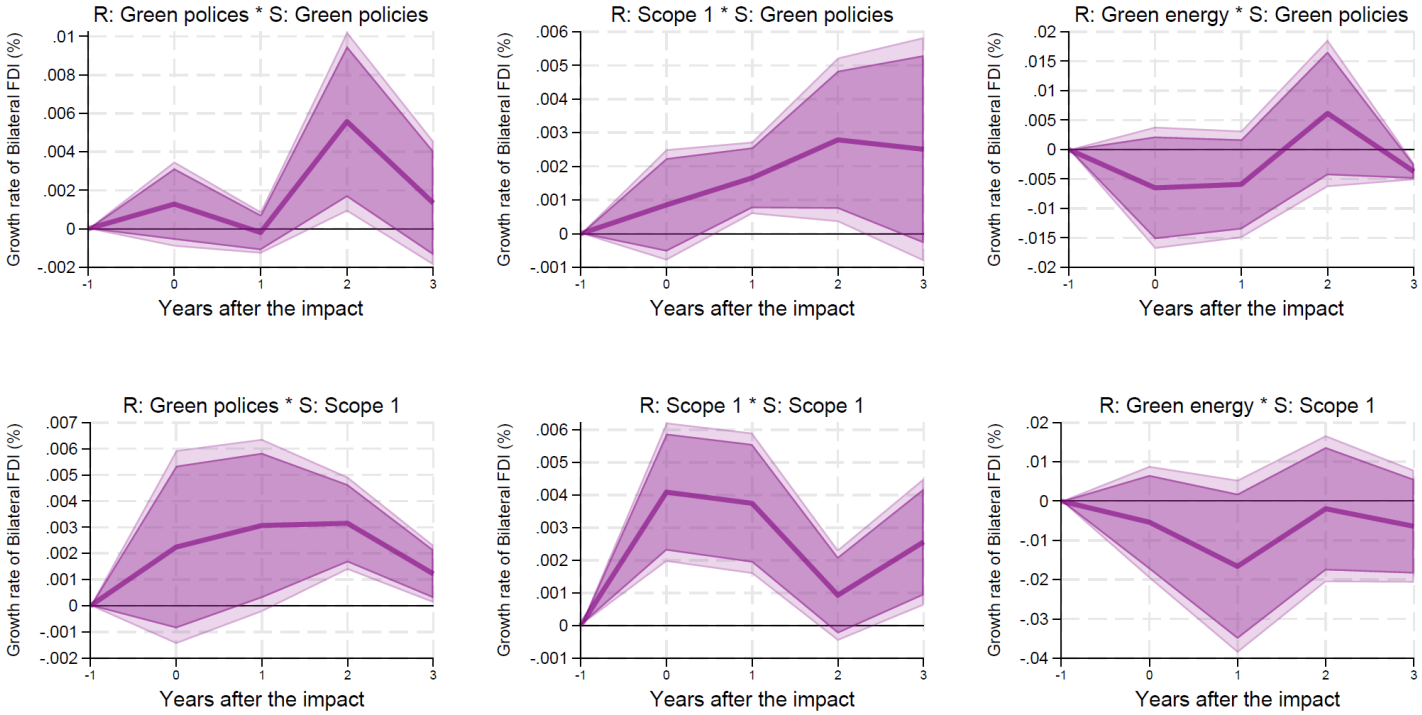
Graph 6. Impact of environmental factors of the receiving country in a sending-receiving country approach.



Note: Impact of receiving-country environmental characteristics on bilateral FDI inflows to EMEs. These regressions control for receiving, sending and time fixed effects and includes a vector of domestic and foreign country characteristics. Light area: confidence intervals at 95%; dark area: confidence intervals at 90%. Driscoll-Kraay standard errors.

Results of the recipient-sending country approach largely confirm those of the recipient country approach, with one exception. Graph 6.A confirms the negative impact of extreme weather events in receiving countries on FDI inflows. Panel B corroborates the favourable influence of a greener energy mix in the recipient country on FDI. By contrast, the results concerning receiving country policies and reporting requirements (panels C and D) switch once one controls for sending country factors. Instead of boosting FDI, as indicated by the "seal of approval" hypothesis, more stringent policies and reporting requirements are associated with lower FDI, in line with the 'cost of doing business' hypothesis, at least in the short run. In the long run, the negative impact of a larger reporting population in receiving countries flips to positive, supporting the 'seal of approval' hypothesis.

Graph 7. Estimations confirm the seal of approval hypothesis. An increase of green regulation in the receiving country is benefited from higher regulation in the sending country.



Note: Impact of the interaction term between receiving and sending environmental characteristics on bilateral FDI inflows to EMEs. R: denotes the environmental factor interacted from the receiving country; S: denotes the environmental factor interacted from the sending country. These regressions control for receiving, sending and time fixed effects and includes a vector of domestic and foreign country characteristics. Light area: confidence intervals at 95%; dark area: confidence intervals at 90%. Driscoll-Kraay standard errors.

- Panel A, B, D and E: The estimations confirm that higher regulation in the sending country positively influences FDI inflows when receiving countries enhance their own green regulations. This interaction amplifies the positive effects or mitigates the negative impacts of regulatory measures in the receiving countries.

5. Robustness

6.1 Different sample split dates

6. Policy discussion

7. Conclusion

Environmental considerations are likely to play a growing role in capital allocation in the coming years. Some activities will become more expensive or simply unfeasible whereas others will gain importance.

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