“Do institutional quality and capital account openness affect capital flow? Evidence from Asian bond markets”

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ARTICLE INFO	Swarupa Ranjan Panigrahi, Suresha B., Krishna T. A., Latha Ramesh and Nijumon K. John (2025). Do institutional quality and capital account openness affect capital flow? Evidence from Asian bond markets. *Investment Management and Financial Innovations*, *22*(2), 155-168. doi:10.21511/imfi.22(2).2025.13
DOI	http://dx.doi.org/10.21511/imfi.22(2).2025.13
RELEASED ON	Thursday, 24 April 2025
RECEIVED ON	Tuesday, 24 December 2024
ACCEPTED ON	Monday, 10 March 2025
LICENSE	This work is licensed under a Creative Commons Attribution 4.0 International License
JOURNAL	"Investment Management and Financial Innovations"
ISSN PRINT	1810-4967
ISSN ONLINE	1812-9358
PUBLISHER	LLC “Consulting Publishing Company “Business Perspectives”
FOUNDER	LLC “Consulting Publishing Company “Business Perspectives”

NUMBER OF REFERENCES	NUMBER OF FIGURES	NUMBER OF TABLES
76	1	6

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BUSINESS PERSPECTIVES

LLC "CPC "Business Perspectives"
Hryhorii Skovoroda lane, 10,
Sumy, 40022, Ukraine

www.businessperspectives.org

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DO INSTITUTIONAL QUALITY AND CAPITAL ACCOUNT OPENNESS AFFECT CAPITAL FLOW? EVIDENCE FROM ASIAN BOND MARKETS

Received on: 24th of December, 2024
Accepted on: 10th of March, 2025
Published on: 24th of April, 2025

© Swarupa Ranjan Panigrahi, Suresha B., Krishna T. A., Latha Ramesh, Nijumon K. John, 2025

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Conflict of interest statement:
Author(s) reported no conflict of interest

Abstract

Capital inflow into local bond markets helps countries with infrastructure financing, funding fiscal deficit, enhancing bond market liquidity, and diversifying investment portfolios globally. This study aims to assess the impact of institutional quality and capital account openness on capital inflow into Asian local bond markets for the period 2002–2023. For reflecting Asian bond markets, seven countries, namely, China, Malaysia, South Korea, Japan, the Philippines, Indonesia, and Thailand, have been considered. The rule of law, regulatory quality, control of corruption, voice & accountability, political stability, and government effectiveness indices are the various proxies considered in this study to measure the different aspects of institutional quality. Further, the Chinn-Ito index is employed to measure capital account openness. Fixed effect, random effect, and pooled data ordinary least squares are employed as different forms of panel data estimation methods in this study. Moreover, Breusch-Pagan LM and Hausman tests are performed to select the most efficient estimation method. This study reveals that the rule of law, regulatory quality, and control of corruption have a positive influence on capital inflow at a 5% significance level and political stability at a 1% significance level. In contrast, capital account openness has a negative impact at a 1% significance level. However, neither voice & accountability nor government effectiveness have a significant influence over capital inflow. These findings suggest improving the rule of law and regulatory quality, creating policies for political stability, stringent acts against corruption, and controlling capital account openness to encourage capital inflow into local bond markets.

Keywords rule of law, regulatory quality, political stability, control of corruption, government effectiveness, voice & accountability, local bond market, public governance

JEL Classification F32, G15, K22, K12

INTRODUCTION

Over thirty years, Asian countries have experienced a substantial rise in capital inflow. It aids in international portfolio diversification, offsets trade deficits and improves financial market turnover and liquidity (Hussain & Goswami, 2022), reduces dependence on external borrowing, funds critical sectors, increases the supply of foreign exchange reserves, and creates jobs for emerging economies, which are essential for economic stability and growth (Igan et al., 2020; Prakash & Panigrahi, 2021). Despite the favorable effects of capital inflow on the recipient countries, there are some concerns. Capital inflow has a highly fluctuating pattern, which makes domestic financial markets volatile and creates asset price bubbles (Bathia et al., 2023; Roy & Kemme, 2020), leading to economic crises in recipient countries via spillover.

Moreover, it affects exchange rate volatility (Nguyen et al., 2024; Tian et al., 2023). Despite the increasing significance of capital flows in the global economy, the drivers remain underexplored.

The neoclassical theory of capital movement suggests that, under the assumption of unrestricted movement of capital, capital flows from the countries with lower yields to those with higher yields, ultimately leading to yield equalization across countries (Solow, 1956). Contrary to the theory, the capital flow has not reached its full potential due to the presence of various factors, viz. political risks, weak property rights protection, and imperfections in capital markets in high-yielding countries (Alfaro et al., 2008; Lucas Jr, 1990). Moreover, empirical evidence revealed that poor legal frameworks and ineffective law-enforcing countries have smaller capital markets (La Porta et al., 1997). These new findings lead to the classification of drivers of capital flows into institutional factors and non-institutional factors. The volume of literature on institutional factors influencing capital inflow is relatively inadequate, in contrast to the substantial number of investigations on the non-institutional factors (Boonman, 2023; Davis & Zlate, 2023; Feng et al., 2023; Harrison & Reed, 2023; Kaya & Erden, 2023; Newell & Marzuki, 2023). As a result, this study has chosen institutional quality as one of the distinct variables under investigation.

The second exogenous variable considered for this study is capital account openness. It removes legal barriers to capital transfer between two countries and role in strengthening other institutions (Arteta et al., 2003).

Previous studies have exclusively concentrated on assessing the impact of capital account openness or institutional quality variables on capital inflow. However, no study has been found so far, to the best of our knowledge, where the impact of both variables is taken into consideration in a single investigation. Therefore, this study attempts to address this gap by exploring the influence of institutional quality and capital account openness on capital inflows. This investigation revolves around Asian countries, which are known to be highly heterogeneous in terms of the exogenous variables investigated in this study. On this backdrop, seven Asian countries have been considered: China, Malaysia, South Korea, Japan, the Philippines, Indonesia, and Thailand.

1. LITERATURE REVIEW AND HYPOTHESES

Institutional quality and capital account openness are widely recognized as important drivers of capital inflow in developing and developed countries. FDI, foreign portfolio inflows, equity market capital flows, and capital flows in the bond market represent distinct forms of capital inflow. Multiple empirical studies have been conducted on the impact of institutional quality on distinct forms of capital inflow. While Kollamparambil and Gumbo (2018) revealed that poorer institutional quality in emerging market economies can lead to capital flight, high institutional quality has a positive impact on FDI in South and Southeast Asia (Bhujabal et al., 2024), in India (Ur Rehman et al., 2021), in India, South Africa, and Brazil (Gupta et al., 2024), and developed economies (Akhtaruzzaman et al., 2017). Contrary to this, interestingly, it has a negative impact on FDI in Russia (Gupta et al., 2024). Moreover, financial development and natural resource abundance positively moderate the relationship between institutional quality and FDI inflow (Chen & Jiang, 2023). Further, institutional quality positively impacts foreign portfolio inflow in nine African nations (Makoni, 2020). Burger et al. (2015) revealed that US investor has substantially increased their holdings in investor-friendly emerging local currency bond markets. Gelos et al. (2022) revealed that countries with better institutions and central bank transparency impact less foreign portfolio inflow volatility due to global shocks in the medium term.

One dimension of institutional quality that the researchers focus on is the control of corruption. It has a positive impact on FDI inflow in Asian countries (Le & Kim, 2021), ASEAN countries (Nguyen, Doan, & Bui, 2021), and lower-middle-income countries (Saha et al., 2022). However, in contradiction, it is found to have a negative impact

http://dx.doi.org/10.21511/imfi.22(2).2025.13

on FDI in developing countries (Qureshi et al., 2021) and OECD countries (Zander, 2021). Some studies have also revealed an insignificant impact on FDI inflow in developing economies (Gupta et al., 2024; Lestari et al., 2022). Political stability is another parameter of institutional quality, and its impact on distinct forms of capital inflow has also been broadly emphasized in the previous literature. Indonesia and the Philippines experienced capital flow volatility during the COVID-19 pandemic period due to political instability (Syarifuddin & Setiawan, 2021). The same result is observed by Murdipi et al. (2023), where political stability reduces the foreign portfolio inflow volatility in developing economies. Further, it also positively affects foreign portfolio allocation decisions in the equity market for developed countries (Kwabi et al., 2023). On a similar line, political conflict in the form of protests and parliamentary-driven reforms in Thailand has a negative impact on capital inflow into the local bond markets (Apaitan et al., 2022; Luangaram & Sethapramote, 2020). In addition, it is observed that FDI flows from the US to destination countries decrease before an election and increase after government formation in destination countries (Julio & Yook, 2016). Further, FDI declined in Pakistan during the time of the apolitical regime (Ramzan, 2021). On the contrary, it does not have any significant impact on FDI in lower-middle-income countries (Saha et al., 2022). Previous studies have also been conducted on the impact of regulatory quality on distinct forms of capital inflow, with consistent observations. Indonesia and the Philippines, with weaker regulatory environments, experienced capital flow volatility during the COVID-19 pandemic period (Syarifuddin & Setiawan, 2021). Adequate regulatory quality compliance enhances FDI in lower-middle-income countries (Saha et al., 2022). Moreover, Agyei et al. (2022) stated that international financial reporting systems (IFRS), competent corporate boards, and regulated effective security markets tend to attract more significant foreign portfolio inflows. On a similar line, adaptation of IFRS increases the foreign portfolio inflow in African countries (Omotoso et al., 2022; Simbi et al., 2023) and in 51 advanced and developing countries (Akisik, 2020). Furthermore, Shovon (2021) revealed that IFRS adoption only increases the foreign portfolio inflow when countries provide investors protection. Government effectiveness is also one of the factors influencing capital flow, as discussed in the literature. India's lack of government effectiveness in implementing the COVID-19 pandemic response caused foreign portfolio flow volatility during this period (Prabheesh et al., 2023). However, it does not have any significant impact on FDI in lower-middle-income countries (Saha et al., 2022). Some other factors are also studied by a few researchers, especially Voice & Accountability and Rule of Law. As observed by Saha et al. (2022), voice & accountability, and the rule of law reduce FDI in lower-middle-income countries. Contrary to the above, the rule of law encourages foreign portfolio inflow in 51 advanced and developing countries (Akisik, 2020; Wu et al., 2012).

Capital account openness is one of the exogenous variables influencing capital inflow. Pasricha et al. (2018) revealed that capital account openness increased gross capital inflow and gross capital outflow in 16 emerging market economies from 2001 to 2012. However, Damasceno and Guedes (2024) investigated 104 emerging market economies from 1980 to 2019 and found an insignificant impact. Makoni (2020) revealed that capital account openness negatively affected foreign portfolio inflow in nine African nations from 2009 to 2016. The same phenomenon is observed by Eguren-Martin et al. (2024). Further, Cerdeiro and Komaromi (2021) found that capital inflow in the equity market in more open emerging market economies is more exposed to changes in US interest rates, and capital flow into the debt market in more open emerging market economies appears more susceptible to changes in expected domestic returns. On the other hand, Gori et al. (2024) found that tightening capital controls in one economy increases capital inflow in the equity market compared to other similar borrowing economies.

After a thorough review of the existing studies, it is observed that most researchers have focused on the impact of institutional quality and capital account openness on capital flow, FDI, and foreign portfolio inflow. However, limited studies explored its effects on local bond markets. This study fills this gap by identifying the impact of institutional quality and capital account openness on capital inflow in local bond markets.

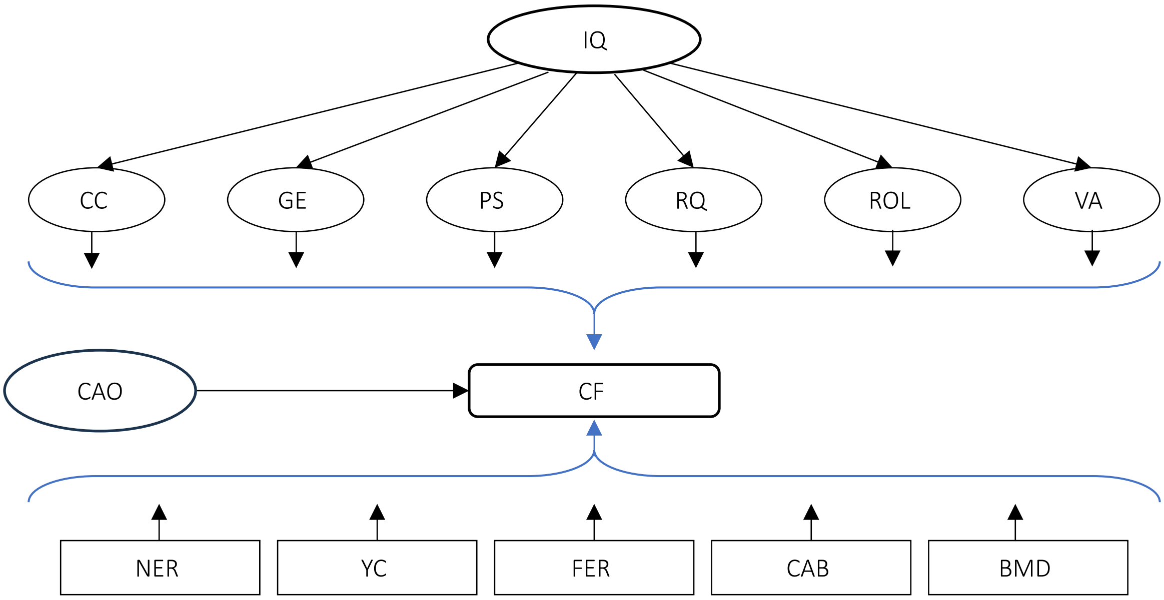

Figure 1. Conceptual framework

Note: In Figure 1, IQ symbolizes institutional quality, CC represents corruption control, GE represents government effectiveness, PS represents political stability, and RQ represents regulatory quality. ROL symbolizes the rule of law. VA signifies voice and accountability; CF indicates capital flow into the local bond market. NER is the nominal exchange rate, YC is the US yield curve, FER is the foreign exchange reserve, CAB is the current account balance, BMD is bond market development, and CAO is capital account openness.

Based on the existing research literature and the research gap, the following hypotheses are proposed:

H1: Institutional quality significantly impacts capital inflow into the local bond markets.

H2: Capital account openness significantly impacts capital inflow in the local bond market.

2. METHODS

The conceptual framework is presented in Figure 1. It shows capital inflow into the local bond market as the dependent variable; Capital account openness and institutional quality are treated as the independent variables. Furthermore, the nominal exchange rate, US yield curve, foreign exchange reserve, current account balance, and bond market development are treated as the control variables. Capital inflow data in seven Asian countries, including China, Malaysia, South Korea, Japan, Philippines, Indonesia, and Thailand, are collected from IMF financial statistics from 2002 to 2023 (International Monetary Fund, 2025)[1], which is frequently used data in most studies (Eller et al., 2020; Gelos et al., 2022; Kaya et al., 2022; Park & Yang, 2021). Control of corruption, government effectiveness, political stability, regulatory quality, rule of law, and voice & accountability are described as different aspects of institutional quality in this study, which are sourced from the worldwide governance indicators (Worldwide Governance Indicators, 2024)[2]. These indices are widely used in research studies for measuring institutional quality (Bhujabal et al., 2024; Cieślik & Goczek, 2018; Lestari et al., 2022; Phuong, 2020; Saha et al., 2022). The data on another exogenous variable, capital account openness, were obtained from the Chinn-Ito Index, an extensively used index for the measurement of de jure capital account openness (Chinn & Ito, 2006)[3]. This Index was widely used in research studies for measuring capital account openness (Aizenman et al., 2020; Amin et al., 2023; Ashenafi & Dong, 2023;

1 https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b&sid=1390030341854

2 https://www.worldbank.org/en/publication/worldwide-governance-indicators

3 https://web.pdx.edu/~ito/Chinn-Ito_website.htm

http://dx.doi.org/10.21511/imfi.22(2).2025.13

Cerdeiro & Komaromi, 2021; Taşdemir, 2023; Yu & Qayyum, 2023). Furthermore, data on control variables are retrieved from IMF financial statistics (International Monetary Fund, 2025)[4], Asian bonds online (Asian Development Bank, 2025)[5], and Federal Reserve Economic Data (Federal Reserve Bank of St. Louis, 2025)[6]. The definitions of all institutional quality indices, capital inflow into local bond market and control variables are presented in Appendix A.

This study employs panel data ordinary least square regression. This method may provide spurious results in the presence of non-stationary time series data (Bhatta et al., 2020). Each non-stationary time series of data is converted into stationary data by taking its first difference. The ADF-Fisher Chi-square unit root test is employed in this study to measure the stationarity of the time series. The ADF-Fisher Chi-square unit root test is presented as

$$\Delta y_t = \alpha + \beta_t + \gamma \cdot Y_{t-1} + \sum_{i=1}^{p} \delta_i \cdot \Delta y_{t-1} + \in_t, \qquad (1)$$

Δy_t – The first difference of y_t, α – A constant intercept, β_t – A time trend term, γ – the coefficient on Y_{t-1}, δ_i – The coefficients of lagged differences of the time series, p – number of lags included to account for higher order serial correlation, $\in_t$ – residual term.

This unit root test is based on hypotheses that is

(H_0) = the time series has a unit root $(\gamma = 0)$.

(H_1) =The time series does not have a unit root. $(\gamma < 0)$.

This study constructs six unbalanced panel data models using ordinary least square regression methods, each focusing on a different aspect of institutional quality. Model R1 evaluates the impact of control of corruption, Model R2 assesses the impact of government effectiveness, Model R3 analyzes the effect of political stability, Model R4 studies the impact of the rule of law, Model R5 investigates the effects of regulatory quality, and Model R6 explores the impact of voice & accountability, on capital inflow in local bond markets.

These panel data ordinary least square regression methods consist of seven countries for 22 years, eliminating concerns regarding endogeneity. Finally, this study employs static models such as fixed effect, random effect, and pooled data ordinary least square models as the unbalanced panel data regression models.

The pooled ordinary least square model is the combination of all the observations into one large dataset and estimates of a standard ordinary least square regression. This model assumes that all units are homogeneous and that there are no individual or time effects that could affect the relationship between the independent variables (Ceesay & Moussa, 2022). The pooled ordinary least square model is illustrated by Equation (2).

$$CF_{it} = \alpha + \beta_1 \cdot IQ_{it} + \beta_2 \cdot CAO_{it} + \beta_3 \cdot X_{it} + \in_{it}, \qquad (2)$$

CF_{it} is the capital inflow in the local bond market, *α is the individual-specific effect, which is constant for all observations,* X_{it} are the control variables in the model, $\in$ is the residual in the model, IQ_{it} is the institutional quality index, and CAO_{it} is the capital account openness. β_1 is the coefficient of IQ_{it}, and β_2 is the coefficient of CAO_{it}.

The random effect model assumes that the individual-specific effects are random and uncorrelated with the explanatory variables. The random effect model is delineated in Equation (3).

$$CF_{it} = \alpha + \beta_1 \cdot IQ_{it} + \beta_2 \cdot CAO_{it} + \beta_3 \cdot X_{it} + U_i + \in_{it}, \qquad (3)$$

CF_{it} is the capital inflow in the local bond market, *α is the individual-specific effect, which is constant for all observations,* X_{it} are the control variables in the model, $\in$ is the residual in the model, IQ_{it} is the institutional quality index, and CAO_{it} is the capital account openness. β_1 is the coefficient

4 https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b&sid=1390030341854

5 https://asianbondsonline.adb.org/

6 https://fred.stlouisfed.org/

of IQ_{it}, and β_2 is the coefficient of CAO_{it}. U_i is the individual-specific effect, which is uncorrelated with IQ_{it}, CAO_{it}, and X_{it}.

The fixed effect model accounts for individual-specific heterogeneity by assuming that each cross-sectional unit has its unique characteristics. The key assumption is that the unobserved individual effects are correlated with the explanatory variables. The fixed-effect model is outlined in Equation (4).

$$CF_{it} = \alpha_i + \beta_1 \cdot IQ_{it} + \beta_2 \cdot CAO_{it} + \beta_3 \cdot X_{it} + \in_{it}, \quad (4)$$

CF_{it} is the capital inflow in the local bond market, α_i is the individual-specific heterogeneity, which is constant for each cross-section, X_{it} are the control variables in the model, $\in$ is the residual in the model, IQ_{it} is the institutional quality index, and CAO_{it} is the capital account openness. β_1 is the coefficient of IQ_{it}, and β_2 is the coefficient of CAO_{it}.

The Hausman test and the Breusch-Pagan LM Test for random effects are employed to select the most suitable model among the fixed effect, the random effect, and the polled ordinary least square model. The primary assumption of the Hausman test is that the fixed effect will provide consistent estimates if the individual effects are correlated with the explanatory variables, while the random effect will not (Hausman, 1978). The Hausman test is based on two hypotheses.

H_0: *Random effects model is appropriate, and*

H_1: *Fixed effects model is appropriate.*

The Breusch-Pagan LM test for random effects is based on two hypotheses (Breusch & Pagan, 1980). $H_{0:}$ Pooled ordinary least square model is appropriate, and $H_{1:}$ The random effect model is appropriate

Based on the two tests, this study finalizes the appropriate panel data regression model.

3. RESULTS AND DISCUSSION

Table 1 summarizes the descriptive statistics for non-standardized dependent variables and standardized independent and control variables for seven Asian countries from 2002 to 2023. The capital flow into the local bond market is a non-standardized dependent variable having a mean of 0.01, a standard deviation of 0.02, a maximum of 0.07, and a minimum of –0.05. The other standardized independent and control variables have a mean of 0 and a standard deviation of 1. The descriptive statistics of all variables are presented in Table 1.

The pairwise correlation coefficients for all the variables are presented in Table 2. The pairwise correlation coefficient between the different aspects of the institutional quality index is more than 70%, which indicates that the six institutional quality

Table 1. Descriptive statistics of research variables

Variable	CF	BMD	CAB	CC	NER	FER	GE	CAO	PS	RQ	ROL	YC	VA
Mean	0.01	0	0	0	0	0	0	0	0	0	0	0	0
Median	0.01	(0.3)	(0.1)	(0.4)	(0.1)	(0.1)	(0.25)	(0.29)	(0.2)	(0.3)	(0.29)	0.17	0.06
Maximum	0.07	2.92	3.68	2.23	4.12	2.25	2	1.7	1.73	1.9	1.89	2.05	1.46
Minimum	(0.05)	(1.3)	(2)	(3.1)	(2.6)	(1.5)	(1.89)	(1.15)	(2.2)	(2.1)	(1.52)	(2)	(2.03)
Std. Dev.	0.02	1	1	1	1	1	1	1	1	1	1	1	1
Skewness	0.51	1.04	1.15	0.57	0.79	0.4	0.16	0.59	(0)	0.2	0.42	0.05	(0.44)
Kurtosis	4.95	3.47	5.24	2.99	4.98	2.18	1.86	2.15	2.04	1.9	1.76	2.38	2.44
Observations	142	142	142	142	142	142	142	142	142	142	142	142	142

Note: In Table 1, IQ symbolizes institutional quality; CC represents corruption control; GE represents government effectiveness; PS represents political stability; and RQ represents regulatory quality. ROL symbolizes the rule of law. VA signifies voice and accountability; CF indicates capital flow into the local bond market. NER is the nominal exchange rate, YC is the US yield curve, FER is the foreign exchange reserve, CAB is the current account balance, BMD is bond market development, and CAO is capital account openness. ( ) represents negative numbers in Table 1.

http://dx.doi.org/10.21511/imfi.22(2).2025.13

Table 2. Pairwise correlation coefficient of all the variables in the model

	CF	BMD	CAB	CC	NER	FER	GE	CAO	PS	RQ	ROL	YC	VA
CF	1												
BMD	0.2	1											
CAB	0.02	0.2	1										
CC	0.22	0.89*	0.14	1									
NER	(0.12)	0.08	(0.3)	0.06	1								
FX.	(0.01)	0.07	0.55	(0.09)	(0)	1							
GE	0.2	0.88*	0.33	0.92*	0.02	0.1	1						
CAO	0.12	0.67	(0)	0.7	0.04	(0.43)	0.57	1					
PS	0.19	0.79	0.22	0.89*	0.04	(0.03)	0.91*	0.6	1				
RQ	0.21	0.83*	0.18	0.9*	0.05	0	0.92*	0.67	.86*	1			
ROL	0.21	0.88*	0.21	0.94*	0.01	(0.02)	0.95*	0.69	.91*	.95*	1		
YC	(0.13)	(0.23)	0.18	(0.09)	(0.2)	(0.08)	(0.13)	0.01	(0.1)	(.1)	(.07)	1	
VA	0.24	0.52	(0.2)	0.66	0.07	(0.49)	0.53	0.81*	0.52	.73*	0.67	0.06	1

Note: In Table 2, IQ symbolizes institutional quality; CC represents corruption control; GE represents government effectiveness; PS represents political stability; and RQ represents regulatory quality. ROL symbolizes the rule of law. VA signifies voice and accountability; CF indicates capital flow into the local bond market. NER is the nominal exchange rate, YC is the US yield curve, FER is the foreign exchange reserve, CAB is the current account balance, BMD is bond market development, and CAO is capital account openness. () represents negative numbers in Table 2. All * indicators show that the pairwise correlation coefficient is more than 70%.

indicators exhibit a high degree of correlation coefficients, suggesting that multicollinearity may be an issue among the institutional quality indicators. This study constructed six different regression models based on six different Institutional qualities to address the multicollinearity among the institutional quality variables. All * indicators presented in Table 2 indicate that the pairwise correlation coefficient is more than 70%.

Moreover, the ADF Fisher Chi-square test is employed to assess the stationarity of the time series data. The results of the ADF Fisher Chi-square test are presented in Table 3. Bond market development, foreign exchange reserve, government effectiveness, capital account openness, US yield curve, and voice & accountability time series are stationary at first difference.

This study employs R1, R2, R3, R4, R5, and R6 regression models based on institutional quality parameters such as control of corruption, government effectiveness, political stability, regulatory quality, rule of law, and voice & accountability.

Table 3. Results of the unit root ADF – Fisher Chi-square test

Variable	Level	t-Statistics	Probability	First Diff	t-Statistics	Probability
CF	Level	54.88	0			
BMD	Level	8.48	0.86	BMD	67.08	0.000
CAB	Level	21.66	0.09			
CC	Level	22.93	0.06			
NER	Level	68.47	0			
F.ER.	Level	17.85	0.21	FER	74.98	0.0000
GE	Level	18.54	0.18	GE	105.59	0.0000
CAO	Level	9.97	0.44	CAO	74.52	0.0000
PS	Level	41.06	0			
RQ	Level	24.06	0.05			
ROL	Level	24.5	0.04			
YC	Level	7.07	0.93	YC	95.68	0.0000
VA	Level	16.42	0.29	VA	66.39	0.0000

Note: In Table 3, IQ symbolizes institutional quality; CC represents corruption control; GE represents government effectiveness; PS represents political stability; and RQ represents regulatory quality. ROL symbolizes the rule of law. VA signifies voice and accountability; CF indicates capital flow into the local bond market. NER is the nominal exchange rate, YC is the US yield curve, FER is the foreign exchange reserve, CAB is the current account balance, BMD is bond market development, and CAO is capital account openness.

Table 4. Hausman test and Breusch-Pagan LM tests for random effects

Tests	R1	R2	R3	R4	R5	R6
Hausman Test Statistic	3.98	3.95	4.55	3.82	5.52	3.88
Hausman probability	0.78	0.78	0.72	0.80	0.60	0.79
BP– LM Test Statistics	0.39	3.19	0.48	1.37	1.67	3.22
BP– LM Test probability	–0.53	–0.07	0.49	0.24	0.20	0.07
Appropriate Model	Pooled OLS	RE	Pooled OLS	Pooled OLS	Pooled OLS	RE

Note: Pooled OLS stands for Pooled ordinary least squares method, and RE stands for random effect method

Based on the Hausman test and Breusch-Pagan LM tests for random effects, this study selects the most efficient regression model, which is presented in Table 4.

Hausman test and Breusch-Pagan LM tests for random effects of R1, R2, R3, R4, R5, and R6 regression models are presented in Table 4. It shows that the Hausman test statistics with p-values and accepted random effect are more efficient than fixed effect in all regression models (Hausman, 1978). Moreover, the Breusch-Pagan LM tests for random effects test statistics with p values show that the pooled ordinary least squares model is the more efficient model for R1, R3, R4, and R5 (Breusch & Pagan, 1980), and the random effect model is more efficient for

Table 5. Panel data regression model

Variable	R1	R2	R3	R4	R5	R6
	Pooled OLS	**RE**	**Pooled OLS**	**Pooled OLS**	**Pooled OLS**	**RE**
C	0.01*	0.01*	0.01*	0.01*	0.01*	0.01*
	(–6.81)	(–4.14)	(6.8)	(6.16)	(6.19)	(4.16)
BMD	0	0.01	0	0.01	0.01	0.01
	(–0.05)	(–0.92)	(0.04)	(1.02)	(0.89)	(0.92)
CAB	0	0	0	0	0	0
	(–0.99)	(–0.83)	(–1.21)	(–0.75)	(–0.83)	(–0.84)
NER	0	0	0	0	0	0
	(–1.11)	(–1.38)	(–1.12)	(–1.15)	(–1.1)	(–1.41)
FER	0.01***	0.01***	0.01**	0.01	0.01	0.01***
	(–1.89)	(–1.82)	(2.06)	(1.58)	(1.62)	(1.81)
CAO	–0.02*	–0.01*	–0.02*	–0.02*	–0.02*	–0.01
	(–3.37)	(–3.01)	(–3.41)	(–3.27)	(–3.29)	(–3.01)
YC	0.00**	0	0.00***	0	0	0
	(–1.88)	(–1.30)	(–1.86)	(–1.45)	(–1.51)	(–1.31)
CC	0.01**			0.001**		
	(–2.76)			(2.27)		
GE		0			0.001**	
		0			(2.31)	
PS			0.01*			
			(2.71)			
RQ				0.001**		
				(2.27)		
ROL					0.001**	
					(2.31)	
VA						0
						(–0.02)
R-squared	0.21	0.17	0.21	0.18	0.19	0.17
Adjusted *R*-squared	0.17	0.13	0.17	0.15	0.15	0.13
F-statistic	5	3.84	4.96	4.63	4.67	3.84
Prob (*F*-statistic)	0	0	0	0.00	0	0

Note: In Table 5, IQ symbolizes institutional quality, CC represents corruption control, GE represents government effectiveness, PS represents political stability, and RQ represents regulatory quality. ROL symbolizes the rule of law. VA signifies voice and accountability; CF indicates capital flow into the local bond market. NER is the nominal exchange rate, YC is the US yield curve, FER is the foreign exchange reserve, CAB is the current account balance, BMD is bond market development, and CAO is capital account openness. The symbols used for significance levels are as follows: * indicates p < 0.01, ** indicates p < 0.05, and *** indicates < 0.1. Values in parentheses represent the corresponding t-statistics. Pooled OLS represents the pooled ordinary least square estimation method. RE represents the random effect estimation method.

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R2 and R6. Both tests identified the Pooled ordinary least squares model as the most appropriate model for R1, R3, R4, and R5 and the random effect model as the most appropriate model for R2 and R6. Furthermore, the final six regression models are presented in Table 5.

Control of corruption, regulatory quality, and rule of law have a positive impact on capital inflow at a 5% significant level. Moreover, political stability has a positive impact on capital flow at a 1% Significance level. However, government effectiveness and voice & accountability have no impact on capital inflow. Capital account openness has a negative impact on capital flow at a 1% level of significance in the R1, R2, R3, R4, and R5 regression models. In the R6 regression model, however, it has no impact.

Control of corruption positively impacts capital flow in the local bond market in Asian economies. The finding is consistent with earlier studies, reinforcing the established knowledge in the field (Al-Smadi, 2018; Jain et al., 2017; Kharabsheh & Gharaibeh, 2022; Omotoso et al., 2022; Yunan & Pacheco-Jaramillo, 2024). However, it contradicts the work of Qureshi et al. (2021) and Zander (2021). Government effectiveness has no significant impact on capital flow in the Asian local bond market, which aligns with Saha et al. (2022) and contradicts Prabheesh et al. (2023). On the other hand, regulatory quality is found to have a positive impact on capital inflow in the local bond market, which reinforces prior research, deepening insights into fundamental principles of the field (Agyei et al., 2022; Akisik, 2020; Gelos et al., 2022; Omotoso et al., 2022; Shovon, 2021; Simbi et al., 2023). Political stability has a positive impact on capital inflow in the Asian local bond market, which supports previous studies (Apaitan et al., 2022; Julio & Yook, 2016; Kwabi et al., 2023; Luangaram & Sethapramote, 2020; Ramzan, 2021). Further, the rule of law has a positive impact on capital inflow in the local bond market and is found to be aligned with Akisik (2020) and Wu et al. (2012). However, the impact of both the variables, viz. political stability and rule of law, contradicts the work of Saha et al. (2022). The impact of voice & accountability on capital inflow is observed to be insignificant. This result is again contrary to Saha et al. (2022), who claimed that voice & accountability have a negative impact on FDI.

Furthermore, capital account openness consistently has a negative impact on capital flow across all models. It supports the study by Makoni (2020) and contradicts previous studies (Ahmed & Zlate, 2014; Damasceno & Guedes, 2024; Eguren-Martin et al., 2024; Ferreira & Miguel, 2011; K. Forbes et al., 2016; Forbes & Warnock, 2012; Pasricha, 2018; Sarno et al., 2016).

CONCLUSION

This study investigates the impact of institutional quality and capital account openness on capital inflow in the Asian local bond market. It uses control of corruption, government effectiveness, political stability, rule of law, regularity quality, and voice & accountability indices as different indicators of institutional quality. Moreover, the Chinn-Ito Index is used to measure capital account openness. Descriptive statistics are first applied to explanatory, response, and control variables. Following that, pairwise correlation analyses are performed, revealing multicollinearity among the various institutional quality indices. To rectify this problem, six panel OLS models are developed, each based on different indicators of institutional quality. Furthermore, to avoid producing spurious findings in any model, stationarity for all variables in the time series data must be established. The ADF Fisher chi-square test is used to assess it. The first difference of non-stationary time series variables is used in each model to avoid spurious results. Furthermore, Hausman and Breusch-Pagan LM tests for random effects are used to select the most efficient models from pooled data, fixed effect, and random effect panel OLS regression models. The rule of law, regulatory quality, and control of corruption were found to have a moderate and political stability to a strong degree to have a positive effect on capital inflows. However, no significant impact of government effectiveness and voice & accountability on capital inflow in the local bond market is found. Furthermore, it is found that capital account openness strongly negatively affects capital inflow in the local bond market. These findings have significant implications for policymakers. The study suggests that further increases in capital account openness could hinder capital inflow in the local bond markets. To enhance capital inflow in the local bond market, governments should focus on improving the enforcement of contracts and property rights, regulatory efficiency, political stability, anti-corruption measures, and policies for private sector development. In the future, researchers should explore the impact of the intersection effect of institutional quality and capital account openness on capital inflow in the local bond market. This area remains to be explored by the research community.

AUTHOR CONTRIBUTIONS

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APPENDIX A

Table A1. Operational definition of variables

Variables	Description
Capital inflow into the local bond market	The ratio between capital inflow into the local bond market and Nominal GDP
Control of Corruption Index	It is evaluated by people's perceptions of public power used for private gain. The value of the Index ranges from –2.5 to 2.5, where –2.5 indicates the lowest value in the Index, and 2.5 is the highest value in the Index
Government Effectiveness Index	The Index is observed by capturing perceptions of the quality of public services and their independence from political pressures. The value of the Index ranges from –2.5 to 2.5, where –2.5 indicates the lowest value in the Index, and 2.5 is the highest value in the Index.
Political Stability Index	It was measured by perceptions of government destabilization caused by unconstitutional activities. The value of the Index ranges from –2.5 to 2.5, where –2.5 indicates the lowest value in the Index, and 2.5 is the highest value in the Index
Rule of Law Index	It was assessed based on perceptions of contract enforcement, property rights, and independent judiciary. The value of the Index ranges from –2.5 to 2.5, where –2.5 indicates the lowest value in the Index, and 2.5 is the highest value in the Index
Regulatory Quality Index	It was determined based on the government's capacity to create and enforce laws and regulations that promote private-sector development. The value of the Index ranges from –2.5 to 2.5, where –2.5 indicates the lowest value in the Index, and 2.5 is the highest value in the Index
Voice & Accountability Index	It was assessed based on the perceptions of people's participation in government elections, freedom of expression, and free media. The value of the Index ranges from –2.5 to 2.5, where –2.5 indicates the lowest value in the Index, and 2.5 is the highest value in the Index.
Bond market development	It was quantified as the bond market size concerning its nominal GDP
Foreign exchange reserves	It was defined as the ratio between foreign exchange reserves and nominal GDP
US yield curve	The US yield curve was measured as the difference between 10-year US government bond yields and 3-month treasury bill yields
Nominal exchange rate	The variability between the local currency's value and the US dollar implies a change in the nominal exchange rate
Current account balance	The current account balance was assessed by the size of the current account balance as a percentage of the nominal GDP

 http://dx.doi.org/10.21511/imfi.22(2).2025.13