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The Role of Trade Openness in Shaping the Relationship Between Foreign Direct Investment and Income Inequality

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Abstract

Foreign direct investment (FDI) and trade openness are key elements of economic globalization, but their impact on income inequality is ambiguous. This study aims to explore the impact of FDI on income inequality and the moderating effect of trade openness among countries. A quantitative longitudinal research design was used with 992 country-year observations from 58 countries for 1990–2024. Secondary macroeconomic data were analysed with descriptive statistics, Pearson correlation analysis, pooled ordinary least squares regression, fixed-effects panel models and interaction-based moderation analysis. The results indicated that there was no statistically significant relationship between FDI and the level of income inequality in the main regression specifications. The pooled regression showed a significant negative association while the two-way fixed-effects model showed a positive association between trade openness and inequality. A simultaneous statistical effect of FDI and trade openness was not found ($\beta = 0.000207$, $p = 0.409$), suggesting that the relationship between FDI and trade openness was not consistent enough. In the case of control variables, a positive significant relationship was found between inflation and income inequality, and between financial development and income inequality, while other variables were not statistically significant. Robustness assessments showed differences in model specification and alternative measures of inequality. The study finds that the distributional consequences of globalization are tied to the general economic environment, suggesting the need for policies to be inclusive, financial access to be just and social protection measures to be complementary to these policies.

Keywords: Foreign Direct Investment; Trade Openness; Income Inequality; Panel Data Analysis; Economic Globalization.

1. Introduction

Foreign direct investment (FDI) and international trade play an important role in global economic integration, affecting capital accumulation, technological progress, employment, and economic development. FDI helps transfer financial resources, managerial and production technologies, and structural change across countries. But its distribution implications are subject to a nation's economic and institutional arrangements and the state of the labor market. Investment policies are increasingly including the aspects of sustainable development and inclusive growth, and therefore it is important to look at the impacts of investments beyond the aggregate economic results (Trade & Development, 2018). Likewise, international investments and special economic zones affect the spatial distribution of economic opportunities (Ozocakli & Khanalizadeh, 2022). The transformation of production networks also impacts investment flows and development opportunities within economies (Giroud & Ivarsson, 2020).

The other important aspect of globalization is trade openness which allows countries to trade with the rest of the world and to gain access to foreign technologies. However, it is not completely understood what it mean for income inequality. International trade can generate jobs and boost productivity, but unfair access to opportunities can exacerbate income gaps (Dorn et al., 2022). Globalization and financial development have significant implications for income inequality, as has been shown in India (Sethi et al., 2021). Moreover, the distributional impacts of trade liberalisation can differ depending on institutional effectiveness, the model of the economy and the country's development status (Nam et al., 2024).

Although there are some economic advantages to foreign investment, empirical studies show conflicting results on how foreign investment affects income inequality. FDI can help to lower inequality by creating jobs, boosting productivity, and raising household incomes. On the other hand, investments targeted toward capital-intensive sectors or qualified jobs can potentially have a greater impact on the wealthy. Previous literature shows wide international differences in the estimated correlation between FDI and inequality (Huang et al., 2020). Foreign investment flows are also heterogeneous and sectoral differences have a significant impact on the distribution of foreign investment between developed and developing economies (Hekmatpour, 2024). Some Asian economies also provide evidence on the role of national economic features in inequality outcomes (Yuldashev et al., 2023).

These relationships can be affected by trade openness, which can affect market competition, investments and labor demand. At the regional level, the economies of the Commonwealth of Independent States (CIS) provide some important linkages between trade, FDI and income inequality (Khan & Nawaz, 2019). Studies of South Asian nations also reveal the interrelated distributional impacts of foreign investment and trade integration (Khan et al., 2021). The relationship, however, can vary significantly in different economies, and controversy remains about a possible reinforcing or weakening link between trade openness and FDI and income inequality.

The existing studies have investigated globalization, international investment, and income inequality from a variety of regional and methodological perspectives. Sub-Saharan Africa provides evidence of the links between trade openness, FDI and income distribution (Xu et al., 2021). Recent studies also point to several pathways linking trade openness to inequality (Ouedraogo et al., 2025). Furthermore, the results derived from other inequality measures highlight the significance of the choice of indicators in empirical research (Khoso et al., 2021). Outward FDI research also highlights wage bargaining as a determinant of the distributional outcome (Anwar & Sun, 2025).

However, more cross-country longitudinal data is required to check whether the relationship between FDI and income inequality is systematically moderated by trade openness. Past regional studies do not necessarily imply that this interaction continues to hold true over time and countries. This deficiency necessitates panel data analysis which explicitly accounts for an FDI-trade openness interaction and includes the relevant macroeconomic characteristics.

This study aims to examine how Foreign Direct Investment affects income inequality and whether trade openness acts as a moderator in this relationship. To this end the study seeks to explore the direct relationship between FDI and income inequality, directly evaluate the trade openness–inequality link, and measure if the sign of the relationship between FDI and income inequality is strengthened or weakened by the addition of trade openness. It aims to offer empirical findings on the distributional consequences of international economic integration and policy debate on inclusive investment, international trade and equitable economic development through the use of panel regression and interaction-based analysis.

2. Materials and Methods

2.1 Research Design

The research design used in this study was a quantitative longitudinal research design to examine the moderating effect of trade openness in the relationship between foreign direct investment (FDI) and income inequality. The researchers analyzed country-year secondary panel data to determine the relationship of the economy across countries and years. The analytic model used descriptive statistics, correlation analysis, panel regression and moderation analysis based on interaction to test hypotheses of the research.

2.2 Data Sources and Dataset Description

Secondary macroeconomic data were used in the study based on international economic databases, such as World Bank indicators and related income inequality estimates. The dataset used was a sample of 992 country-years (2024-1990) of 58 countries. The imbalanced panel had data on income inequality, FDI, trade openness, economic growth, inflation, population growth, financial development and government expenditure. Standardized panel identifiers were used to identify countries and years, which allowed making longitudinal and cross-country comparisons (Duong, 2026).

2.3 Study Variables and Measurement

The Gini index (GINI WB) was used to measure income inequality and a larger index was associated with higher inequality. FDI was inward net foreign direct investment as a ratio of GDP whereas trade openness (TO) was the aggregate exports and imports of the country as compared to GDP. Control variables were GDP growth (GDP_growth), inflation (IF), population growth (POP), domestic credit to the private sector (CR), and government expenditure (GVE). The openness to trade was considered as an independent variable of explanation as well as a moderator of the FDI-inequality relationship.

2.4 Data Preprocessing

Data preprocessing included looking into missing values, duplicate country-years and variable consistency and extreme observations. The chosen data set included 992 observations with no missing data in the three main research variables or year-country-country combinations. Numerical variables were not changed to other measurement types and the skewed panel design was maintained. A moderation term was created between FDI and trade openness to gauge moderation whereas potentially influential observations were taken into account when evaluating robustness.

2.5 Statistical Analysis

The selected variables were summarized using descriptive statistics, such as means, standard deviations, the minimum values, and maximum values. Pearson correlation was used to determine relationships between economic indicators at an initial stage. The following were the specifications of the pooled ordinary least squares, fixed-effects, and random-effects regression models that were used to test the relationships among FDI, trade openness, and income inequality. Hausman test was used to inform the choice of model, country and year effects were taken into consideration to explain the unobserved heterogeneity and shared time effects. The level of statistical significance was 5%.

2.6 Moderation Analysis

The influence of trade openness was measured by adding an interaction term between FDI and trade openness to the panel regression model. This model was stated as:

$$\begin{aligned} \text{GINI}_{it} = & \beta_0 + \beta_1 \text{FDI}_{it} + \beta_2 \text{TO}_{it} \\ & + \beta_3 (\text{FDI}_{it} \times \text{TO}_{it}) \\ & + \beta_4 \text{GDPG}_{it} + \beta_5 \text{IF}_{it} \\ & + \beta_6 \text{POP}_{it} + \beta_7 \text{CR}_{it} \\ & + \beta_8 \text{GVE}_{it} + \mu_i + \lambda_t + \varepsilon_{it} \end{aligned}$$

Where (GINI) represents income inequality, (FDI) denotes foreign direct investment, and (TO) represents trade openness. (GDPG), (IF), (POP), (CR), and (GVE) are macroeconomic control variables. The terms μ_i , λ_t and ε_{it} represent country effects, year effects, and the error term, respectively. The interaction coefficient β_3 measures the moderating effect of trade openness, evaluated at a 5% significance level.

2.7 Model Diagnostics and Robustness Checks

Multicollinearity, heteroskedasticity and serial-correlation diagnostics were used to test the reliability of the model. Multicollinearity was checked with variance inflation factors and heteroskedasticity and within-country dependence were corrected using clustered robust standard errors. Where possible, robustness checks involved alternative panel specifications, alternative control variable adjustments, and alternative measures of income inequality. When interpreting the estimated relationships, potential endogeneity was taken into account. These procedures were designed to assess the stability and reliability of the main results.

3. Results

3.1 Dataset Characteristics

The data set consisted of an unbalanced panel of 992 observations for 58 countries for the period 1990–2024. The range of country-specific observations was from 1 year to 34 years because of the differences in the availability of temporal data. In the principal regression analysis, all eight variables were used and there were no missing observations (992). As indicated in the descriptive statistics in Table 1, there is large intercountry variation with regard to investment flows, trade integration and macroeconomic conditions.

Table 1. Descriptive Statistics of the Principal Study Variables

Variable	Mean	SD	Minimum	Maximum
Income inequality (Gini)	35.624	7.985	23.000	64.800
FDI (% GDP)	3.956	7.386	−30.658	85.979
Trade openness (% GDP)	79.128	43.481	13.753	250.108
GDP growth (%)	2.731	3.656	−14.630	24.616
Inflation (%)	11.219	112.019	−11.077	2736.971
Population growth (%)	0.681	0.853	−2.517	6.389
Financial development (% GDP)	81.400	49.036	7.125	304.575
Government expenditure (% GDP)	17.899	4.651	2.976	27.816

3.2 Descriptive Statistics

There was significant sample diversity in terms of participation in foreign investment and international trade. The average value of FDI inflows accounted for 3.956% of GDP and mean trade openness was 79.128 % of GDP. The mean Gini index was 35.624, which shows that there is significant variation in the distribution of income among the sampled economies. The dispersion of inflation was especially high, as there were extreme macroeconomic observations. Figure 1 shows the trends in the three key indicators averaged over the year. Standardization was done to allow for visual comparisons where variables were measured on different scales.

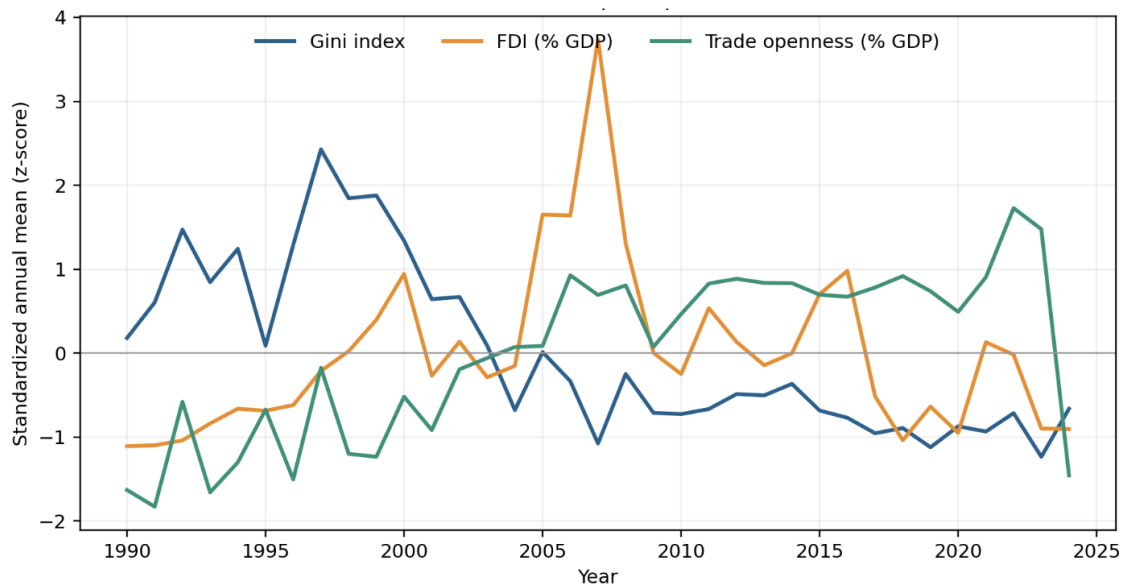


Figure 1. Annual Trends in Income Inequality, FDI, and Trade Openness

3.3 Correlation Analysis

Pearson correlation analysis revealed various patterns of relationship between income inequality, FDI, trade openness and macroeconomic indicators. Income inequality had a negative relationship with FDI ($r = -0.096$) and trade openness ($r = -0.463$) as shown in Table 2. The openness to trade was positively correlated with FDI ($r = 0.308$). Inequality was negatively related to government spending and financial development whereas population growth and inflation were positively correlated. These are the preliminary results of economic relationships, which fail to consider the unobservable country characteristics.

Table 2. Pearson Correlation Matrix of Study Variables

Variable	Gini	FDI	TO	GDPG	IF	POP	CR	GVE
Gini	1.000							
FDI	-0.096	1.000						
TO	-0.463	0.308	1.000					
GDPG	0.106	0.143	0.063	1.000				
IF	0.168	-0.028	-0.089	-0.038	1.000			
POP	0.308	-0.032	-0.171	0.162	0.067	1.000		

CR	-0.208	0.034	0.030	-0.183	-0.030	-0.021	1.000	
GVE	-0.426	0.068	0.205	-0.344	-0.016	-0.299	0.329	1.000

Note. Gini = income inequality; TO = trade openness; GDPG = GDP growth; IF = inflation; POP = population growth; CR = financial development; GVE = government expenditure.

3.4 Direct Effect of FDI on Income Inequality

The baseline pooled OLS regression showed a positive, but statistically non-significant relationship between FDI and income inequality ($\beta = 0.0581$, $p = 0.114$). When country and year fixed effects were added to the equation, the estimated coefficient for the variable became slightly negative ($\beta = -0.0012$, $p = 0.895$). The results in this paper indicate that the FDI – inequality relationship was sensitive to model specification and did not show statistical significance at the 5% level. Figure 2 shows the observed distribution of FDI and income inequality, which is a clear indication of the significant variation in investment flows and inequality outcomes across country-year observations.

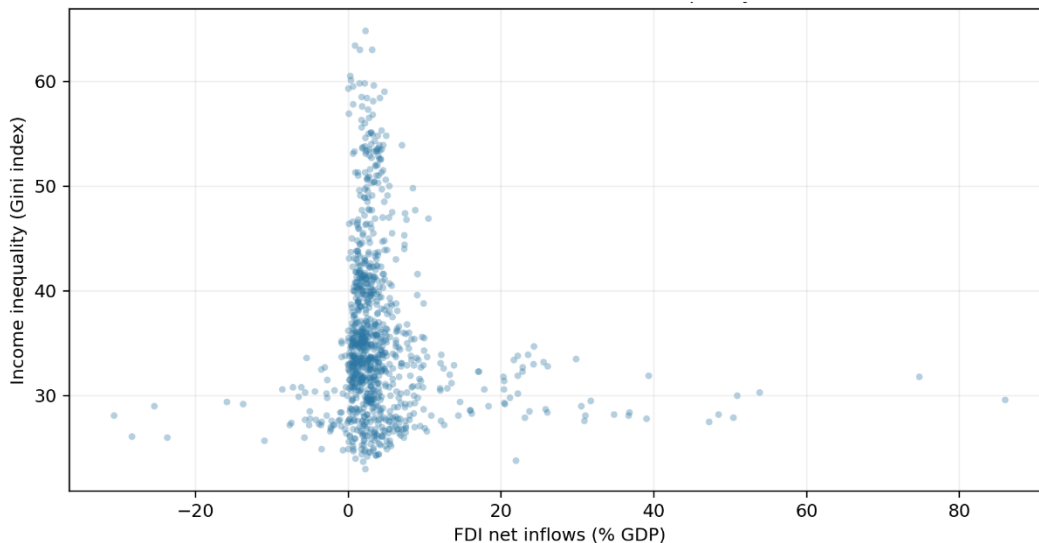


Figure 2. Relationship Between Foreign Direct Investment and Income Inequality

3.5 Direct Effect of Trade Openness on Income Inequality

The openness to trade showed a statistically significant correlation with income inequality, but the direction was different in various regression specifications. The pooled OLS model yielded a negative coefficient (-0.0703 , $p = 0.0005$), which means that higher openness was correlated with lower inequality in the pooled data. On the other hand, the two-way fixed-effects model produced

a positive coefficient ($\beta = 0.0278$, $p = 0.027$), which entailed that within-country gains in openness were correlated with increased inequality when country and year effects were controlled. Table 3 is a summary of the direct relationship between FDI and trade openness under the two specifications.

Table 3. Baseline Panel Regression Results for FDI and Trade Openness

Indicator	Pooled OLS	Two-way FE
FDI coefficient	0.0581	−0.0012
FDI standard error	0.0368	0.0089
FDI p-value	0.114	0.895
Trade openness coefficient	−0.0703	0.0278
Trade openness standard error	0.0203	0.0126
Trade openness p-value	<0.001	0.027
R ²	0.3763	0.9415
Observations	992	992
Country fixed effects	No	Yes
Year fixed effects	No	Yes

3.6 Moderating Effect of Trade Openness

To assess the moderating effect of trade openness, the interaction between mean-centered FDI and trade openness was used. Positive interaction coefficient ($\beta = 0.000207$) but not statistically significant ($p = 0.409$) for the two-way fixed-effects model. The pooled interaction coefficient, however, was negative ($\beta = -0.000784$, $p = 0.370$), and also was not statistically significant. The conditional marginal association of FDI to inequality is shown in Figure 3 at various levels of trade openness. The confidence intervals for the fixed-effects specification did not find a statistically significant moderating effect of trade openness, even though the estimated marginal effect did increase as trade openness increased. So, the main analysis failed to provide any support for the proposed moderation hypothesis.

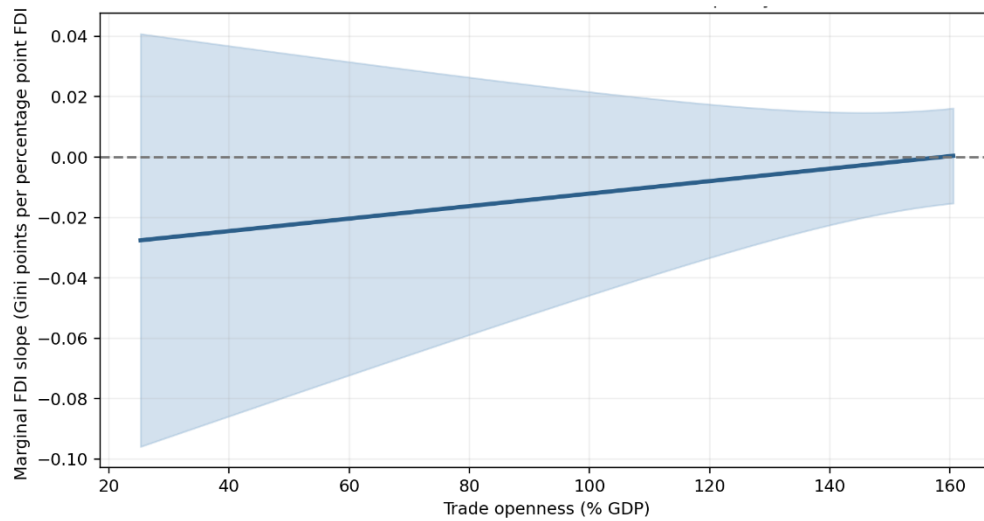


Figure 3. Moderating Effect of Trade Openness on the FDI–Income Inequality Relationship

3.7 Effects of Control Variables

A two-way fixed-effects moderation model was used to analyze the impacts of macroeconomic control variables. Inflation was positively and statistically related to income inequality (Table 4) ($\beta = 0.0016$, $p = 0.013$). There was also a significant positive coefficient between financial and development ($\beta = 0.0176$, $p = 0.015$). There were negative but statistically insignificant relationships between GDP growth and government expenditure whereas population growth exhibited a positive, insignificant coefficient. These results imply that the estimated correlations between macroeconomic conditions and inequality differed among the explanatory indicators.

Table 4. Effects of Macroeconomic Control Variables on Income Inequality

Variable	Coefficient (β)	Std. error	p-value
GDP growth	-0.0203	0.0499	0.684
Inflation	0.0016	0.0006	0.013
Population growth	0.3011	0.2808	0.284
Financial development	0.0176	0.0072	0.015
Government expenditure	-0.0753	0.1357	0.579

Note. Estimates are from the two-way fixed-effects model including FDI, trade openness, and their mean-centered interaction. Standard errors are clustered by country. Statistical significance is evaluated at $p < 0.05$.

3.8 Model Diagnostics and Robustness Results

The moderation effect was compared across the pooled OLS, two-way fixed-effects, pre-2020 fixed-effects, and 2020–2024 fixed-effects specifications in a robustness analysis. The estimated interaction coefficients and 95% confidence intervals are given in Figure 4. The coefficients estimated in the two specifications (pooled and fixed effects) differed in sign, but none were significant. The pre-2020 interaction estimate was 0.000224 ($p = 0.429$), compared with 0.000405 ($p = 0.356$) during 2020–2024. Mixed evidence was also found for alternative inequality measures, with the disposable-income Gini interaction being insignificant ($p = 0.260$), and the market-income Gini interaction being positive and significant ($p = 0.018$). The overall evidence did not support the moderating effect of the specifications and inequality definitions.

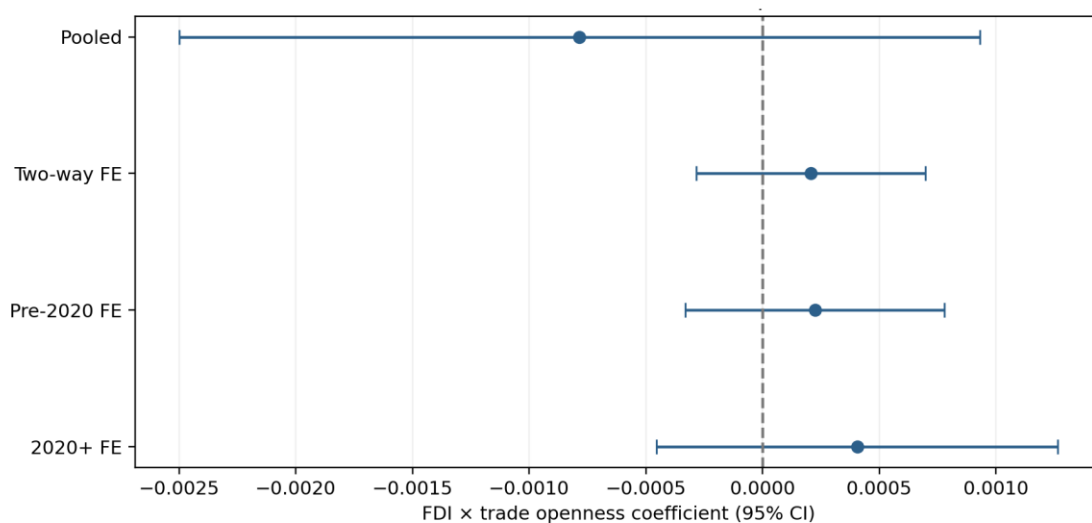


Figure 4. Robustness Comparison of FDI–Trade Openness Interaction Estimates

Heteroskedasticity and dependence across countries were accounted for by clustering standard errors at the country level in the regression analyses. In this analysis, however, the variance inflation factor, serial correlation, cross-sectional dependence, and Hausman tests were not computed. Therefore, no diagnostic test results or model-selection inferences are warranted other than those reported in the regression and robustness results.

4. Discussion

The present study analyzed the linkages between foreign direct investment (FDI), trade openness, and income inequality based on 992 country-year observations across 58 countries for the period 1990–2024. Results showed that there was no statistically significant correlation between FDI and income inequality in the initial model. Overall, there were significant, but opposing, associations between trade openness and both pooled and fixed effects specifications. Moreover, neither FDI nor trade openness interacted statistically, which suggests that there is not enough evidence of a consistent moderating link. These results highlight the complexity of the distributional effects of globalization and the need to separate the cross-country differences from the economic changes within countries (Azémar & Giroud, 2023; Giroud, 2024).

The estimated association between FDI and the level of income inequality turned out to be statistically insignificant with respect to the main regression specifications. The pooled model yielded a positive coefficient, while the fixed-effects model had a slightly negative association. This variation implies that the distributional patterns observed may be influenced by variations in national economic structure and investment conditions. The benefits of FDI may not be equally shared across sectors and among population groups, and can include employment creation, productivity gains and technological progress. Increased attention is paid to ensuring sustainable and inclusive development through foreign investment not only to capital flows, as evidenced by international investment strategies (Development (UNCTAD), 2024; ШТУНДЕР & ШКУРОПАДСЬКА, 2025).

Trade openness significantly and negatively correlated with income inequality in pooled regressions whereas significantly and positively associated with income inequality when the country and year effects are controlled for. The results of these different comparisons suggest that the different features of cross-country and within-country variation reflect different economic relationships. Increased trade integration enhances market access, fosters productivity and generates jobs. But access to export markets, technology, and skilled employment may be unequal, which can help to increase income gaps. Also, the overall connection between international trade and economic diversification indicates that structural conditions can affect the differential impacts of globalization on economic groups (Prasad et al., 2024).

In the primary fixed-effects model, the FDI-t trade openness interaction was not statistically significant ($\beta = 0.000207$, $p = 0.409$). There was no evidence that a system of trade openness would

strengthen or weaken the trade-FDI-income inequality relationship overall, though the estimated coefficient was positive. The results indicate that the integration of international investment and trade activities can take place in a different distribution. Variations in productive structures, investment facilitation, and institutional conditions influence these relationships. Thus, the advantages of international economic integration do not necessarily follow automatically into an equitable income distribution (Facilitation, 2019).

Of the control variables, only inflation and financial development have found significant positive relationship with income inequality statistically. Household financial protection could be lower for those with less financial protection, and higher for others with more access to credit and investment opportunities. The principal model contained no economic or demographic variables that were statistically significant, such as GDP growth, population growth, or government expenditure. The results indicate that the analysis of inequality outcomes should take into account the broader macroeconomic context. The same is true for international economic evaluations, which also highlight the relationship between economic growth, financial conditions, and distributional vulnerabilities (but Slow & amid Divergence, 2024).

The results indicate that policies supporting FDI and trade liberalization need to be accompanied by policies that enable inclusive economic participation. Governments should consider investing in productive investments, skills training, financial inclusion and targeted social protection. Institutional strengthening and enhancing opportunities for disadvantaged people help to share the economic gains more broadly. An inclusive development approach should also aim to tackle structural inequalities, and not only focus based on international capital inflows and trade growth (Chancel et al., 2026; Conceição, 2024).

Limitations of the study are due to the unbalanced structure of the panel, observational design and economic characteristics between different countries. Causal interpretation is limited by the possibility of reverse causality, omitted variables and measurement differences. Alternative identification methods should be used to explore sector-specific FDI, institutional quality and regional heterogeneity and dynamic relationships in future research. More research on income inequality in markets and in disposable income help explain how economic globalization affects distributional outcomes.

5. Conclusion

This study investigated the role of trade openness in shaping the relationship between foreign direct investment (FDI) and income inequality using longitudinal panel data comprising 992 observations from 58 countries between 1990 and 2024. The results showed that FDI had statistically non-significant relationships with income inequality in the main regression specifications, indicating that foreign investment is not always a factor in the changes in the income distribution. Trade openness showed significant but opposite relationships and a negative association in a pooled regression model and a positive association in the fixed effects model. These variations demonstrate the need to consider country-specific features and time variations. The relationship between FDI and trade openness was not statistically significant, which shows there is no substantive evidence to suggest that the relationship between trade openness and FDI is moderated by trade openness systematically. Inflation and financial development were found to have a strong positive correlation with income inequality, whereas economic growth, population growth, and government expenditure were not statistically significant among the macroeconomic controls. Such results highlight the idea that distributional effects of economic globalization are contingent on more general structural and macroeconomic factors. Investment promotion and trade liberalization should be supplemented with inclusive financial policies, employment opportunities and selective social protection measures, as well as, to policymakers. The following studies ought to include institutional quality, industry-specific investment behavior, and other econometric methods in order to have a better comprehension of the relationship linking international economic integration and income inequality.

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