

**DEMOCRACY, AUTOCRACY, AND
EXPROPRIATION OF FOREIGN DIRECT INVESTMENT**

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DEMOCRACY, AUTOCRACY, AND EXPROPRIATION OF FOREIGN DIRECT INVESTMENT

- Expropriation of foreign direct investment is political and directly related to the nature of political institutions. Yet the effect of political institutions has received little systematic theoretical and empirical investigation in international business and political science.
- International business studies ignore the role of domestic political institutions.
- Political science studies typically hold that more democratic countries provide better property rights protection for foreign investors.

- Casual observation suggests that while democracy appears less likely to expropriate foreign assets in general, democracy also engages in expropriation behaviors.
- While autocracy appears to expropriate foreign assets more often, autocracy sometimes appears restrained.

Table 1 Expropriation Acts and Regime Type, 1960-1990, 63 countries

	Autocracy (aclp)	Democracy (aclp)	total
# expropriation acts	426	97	523
# regime years	1403	439	1842
# regime years per expropriation act	3.3	4.5	3.5

RESEARCH QUESTIONS

- What makes democracy more protective of foreign assets than autocracy?
- Under what conditions will a democracy expropriate foreign assets?
- Under what conditions will an autocratic leader restrain itself from expropriating foreign assets?
- Is there a common logic that drives the expropriation of foreign assets across regime types?
- What causal factors set democracy and autocracy apart?

LOGIC OF EXPROPRIATION AGAINST FDI

- Leaders must possess both political incentive and political capacity to expropriate foreign direct investment
- Political incentive to expropriate:
 - FDI--cross border jurisdiction, ex post illiquid nature of investment and long time horizon of investors
 - No expropriation: possible long run steady stream of revenue and possible spillovers in other segments of host economy
 - Expropriation: short term economic & political benefits
 - Long term benefits < short term gains → expropriation more likely
 - time horizon of leaders influences expropriation, regardless regime type

- **Political capacity to expropriate:**
 - More veto players with diverse preferences deter government predation on private sector in general
 - FDI generates winners and losers → relative political power distribution affects ability to expropriate
 - checks and balances, veto players, factions → reduces ability to expropriate
 - applies to both regime types

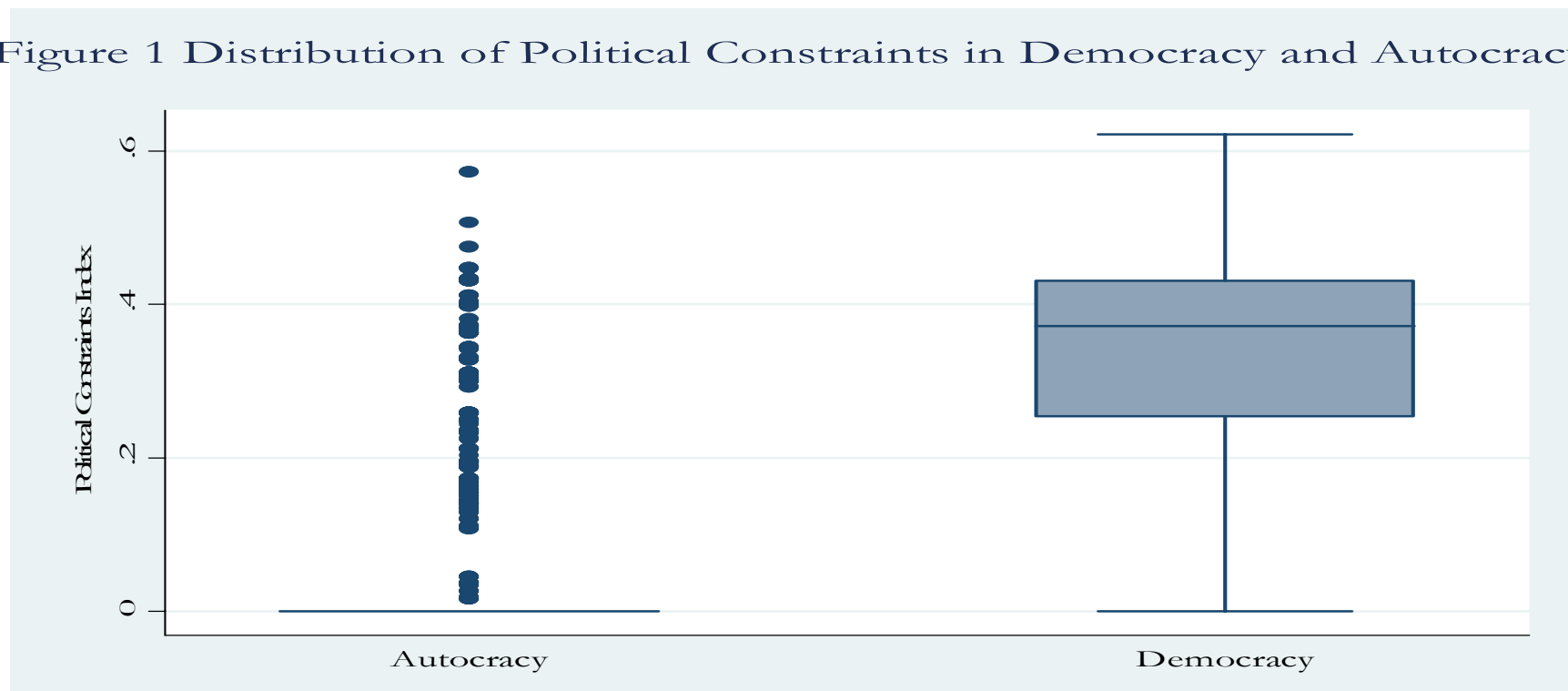
Table 2 Effects of Political Institutions on Expropriation Acts, 1960-1990

	Model 1	Model 2
Political constraints	-1.447*** [0.547]	-2.485*** [0.608]
Executive turnover	1.102*** [0.327]	1.085*** [0.321]
Office tenure to date	-0.053*** [0.013]	-0.024* [0.014]
Expropriation history		-0.054*** [0.015]
Lagged dependent variable		0.129*** [0.025]
GDP per capita		6.524e-04*** [1.928e-04]
GDP per capita squared		-4.332e-08** [2.179e-08]
Growth rate		-0.022** [0.009]
Year		-0.046*** [0.012]
Constant	-1.434*** [0.165]	89.619*** [23.314]
Observations	1794	1737

WHAT SEPARATES DEMOCRACY AND AUTOCRACY?

- **Distribution of Political Constraints across Regimes:**
 - Size of winning coalition, range of interest representation, degree of checks and balances, number of veto players

Figure 1 Distribution of Political Constraints in Democracy and Autocracy



- Different Effects of Executive Turnover and Leader Tenure Across Regime Types

- Presence and absence of regularized election and term limit cause different effects
- Chief executive turnover less frequent and more irregular in autocracy, hard to anticipate, and autocrats repress to prevent turnover—effect of turnover is apparent in democracy, not in autocracy
- Leader tenure to date explains expropriation in autocracy (stationary bandit), but indeterminate in democracy due to regularized election and term limit

Figure 2 Distribution of Executive Turnover in Democracy and Autocracy

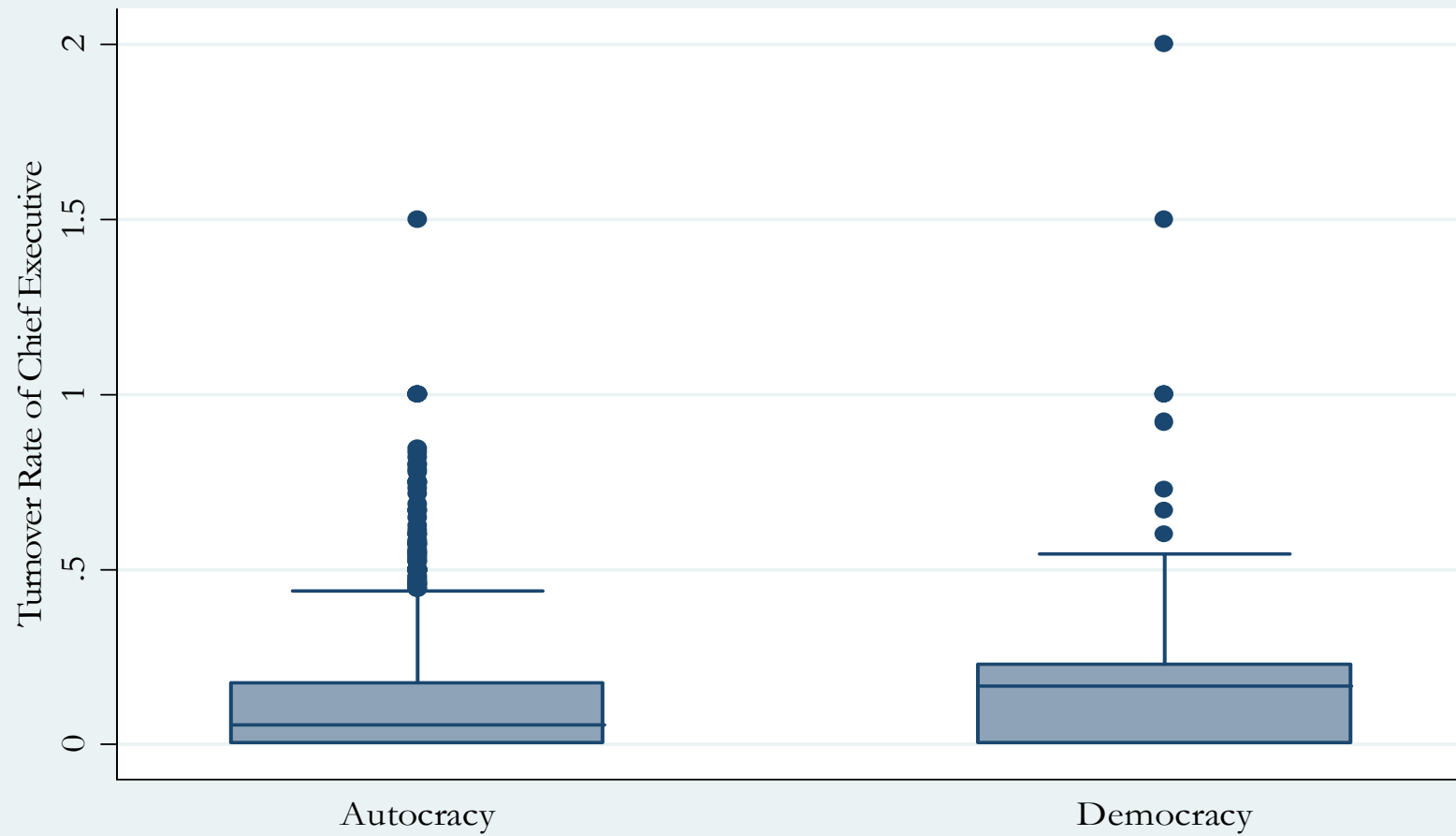


Figure 3 Distribution of Office Tenure in Democracy and Autocracy

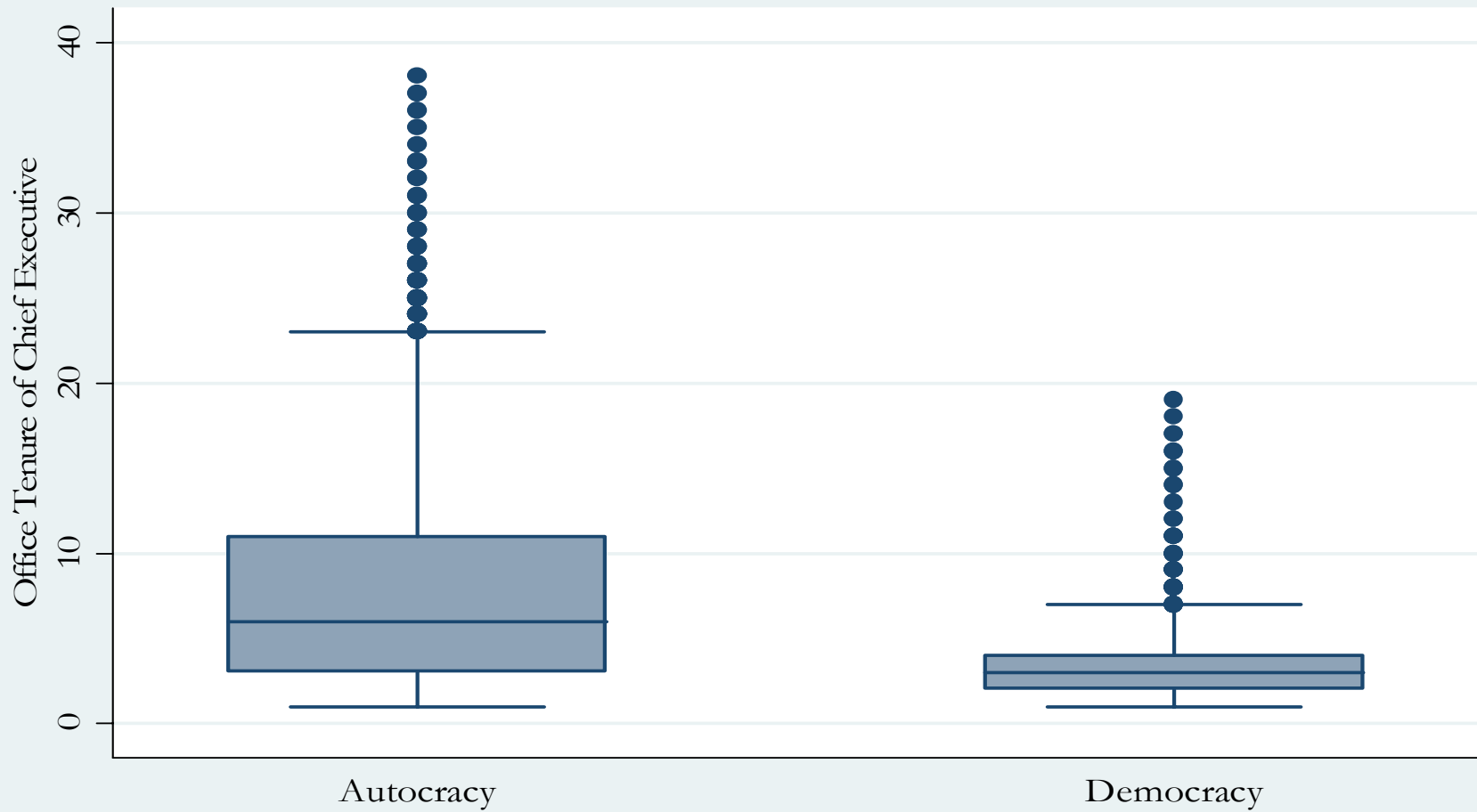


Table 3 Effect of Political Constraints on Expropriations in Democracy and Autocracy, 1960-1990

Democracy Only	Political Constraints above mean (0.33)	Political Constraints below mean (0.33)	total
# expropriations	46	51	97
# regime years	260	167	427
# regime years per expropriation act	5.7	3.3	4.4

Autocracy Only	Political Constraints above 0.04	Political Constraints below 0.04	total
# expropriations	27	392	419
# regime years	220	1153	1373
# regime years per expropriation act	8.2	2.9	3.3

Table 4 Effect of Executive Turnover on Expropriations in Democracy and Autocracy, 1960-1990

Democracy Only	Executive Turnover above mean (0.18)	Executive Turnover below mean (0.18)	total
# expropriations	70	27	97
# regime years	201	238	439
# regime years per expropriation act	2.9	8.8	4.5

Autocracy Only	Executive Turnover above mean (0.12)	Executive Turnover below mean (0.12)	total
# expropriations	143	283	426
# regime years	502	901	1403
# regime years per expropriation act	3.5	3.2	3.3

Table 5 Effect of Leader Office Tenure to Date on Expropriation Acts, 1960-1990

Autocracy only	Autocratic leader tenure above mean (8)	Autocratic Leader tenure below mean (8)	total
# expropriations	93	333	426
# regime years	507	896	1403
# regime years per expropriation act	5.5	2.7	3.3

Democracy only	Democratic leader tenure above mean (3.5)	Democratic Leader tenure below mean (3.5)	total
# expropriations	29	68	97
# regime years	171	268	439
# regime years per expropriation act	5.9	3.9	4.5

Table 6 Effects of Political Institutions on Expropriation Acts: 1960-1990

	Model 1	Model 2
Democracy political constraints	-1.554** [0.696]	-2.252*** [0.743]
Autocracy political constraints	-2.933** [1.241]	-3.932*** [1.307]
Democracy executive turnover	1.062*** [0.365]	1.055*** [0.353]
Autocracy executive turnover	1.173** [0.588]	0.932 [0.590]
Democracy leader tenure to date	0.015 [0.040]	-0.013 [0.045]
Autocracy leader tenure to date	-0.055*** [0.014]	-0.024* [0.014]

WHAT HAVE WE LEARNED?

- Under certain conditions, both democracy and autocracy expropriate or refrain from expropriation.
- What separates the two are fundamental institutional disparities.
- In the literature on how democracy affects FDI, causal channel from democracy to better property rights to more FDI is overly simplistic
- Rule of law is not associated with regime type in a simple manner. Neither democracy nor autocracy always goes hand in hand with strong rule of law.

Table 7 Sensitivity Analyses: Effects of Political Institutions on Expropriation Acts, 1960-1990

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Democracy political constraints	-2.398*** [0.594]	-2.209*** [0.748]	-2.202*** [0.754]	-1.121 [2.031]	-2.370*** [0.756]	-2.395*** [0.761]	-2.239*** [0.741]	-2.285*** [0.747]	-2.348*** [0.747]
Autocracy political constraints	-3.630** [1.487]	-3.922*** [1.308]	-3.539*** [1.287]	-7.056* [4.062]	-3.962*** [1.313]	-3.861*** [1.352]	-4.127*** [1.335]	-4.014*** [1.315]	-3.741*** [1.318]
Democracy executive turnover	0.749*** [0.222]	0.921** [0.445]	0.970*** [0.357]	-0.032 [0.839]	1.052*** [0.354]	1.042*** [0.364]	1.023*** [0.356]	1.049*** [0.353]	1.031*** [0.358]
Autocracy executive turnover	-0.937 [0.588]	0.944 [0.589]	0.695 [0.609]	-5.918*** [2.120]	0.969 [0.592]	1.036 [0.639]	1.030* [0.600]	0.960 [0.588]	0.934 [0.608]
Democracy leader tenure	-0.028 [0.042]	-0.013 [0.045]	-0.014 [0.047]	-0.116 [0.071]	-0.015 [0.045]	-0.014 [0.045]	-0.007 [0.045]	-0.012 [0.045]	-0.018 [0.045]
Autocracy leader tenure	-0.045** [0.023]	-0.024* [0.014]	-0.031** [0.014]	-0.059* [0.032]	-0.024* [0.014]	-0.031** [0.015]	-0.020* [0.015]	-0.026* [0.014]	-0.029** [0.014]
Expropriation History	0.015 [0.020]	-0.053*** [0.015]	-0.060*** [0.015]	-0.159*** [0.037]	-0.054*** [0.015]	-0.060*** [0.015]	-0.054*** [0.015]	-0.053*** [0.015]	-0.058*** [0.015]
Lagged dependent variable	0.240*** [0.036]	0.129*** [0.025]	0.119*** [0.026]	-0.112 [0.070]	0.129*** [0.025]	0.129*** [0.026]	0.139*** [0.026]	0.121*** [0.026]	0.134*** [0.025]
GDP per capita	-5.014e-05 [1.657e-04]	6.436e-04*** [1.952e-04]	1.030e-03*** [2.379e-04]	1.100e-05 [7.747e-04]	8.876e-04*** [3.168e-04]	6.014e-04*** [2.003e-04]	5.955e-04*** [2.004e-04]	6.978e-04*** [2.008e-04]	6.379e-04*** [1.971e-04]
GDP per capita squared	1.525e-08 [1.708e-08]	-4.348e-08** [2.200e-08]	-7.278e-08*** [2.650e-08]	1.420e-08 [4.963e-08]	-6.676e-08** [3.248e-08]	-3.961e-08* [2.216e-08]	-3.932e-08* [2.194e-08]	-5.117e-08** [2.311e-08]	-4.219e-08* [2.205e-08]
Growth rate	-0.030** [0.012]	-0.022** [0.009]	-0.024*** [0.009]	0.015 [0.012]	-0.022** [0.009]	-0.023** [0.010]	-0.021** [0.009]	-0.022** [0.009]	-0.025*** [0.009]
Year	-0.077*** [0.015]	-0.046*** [0.012]	-0.045*** [0.013]	-0.366*** [0.050]	-0.052*** [0.013]	-0.042*** [0.012]	-0.046*** [0.012]	-0.036*** [0.013]	-0.049*** [0.012]
Democratic transition		0.262 [0.528]							
# Democracies in region			-2.825*** [0.768]						
Left				0.705 [0.548]					
Income inequality					-0.029 [0.030]				
Riots						0.018 [0.044]			

Strikes										
War										
Oil exporter										
Primary commodity exporter										
# RTA memberships										
First 3 years post independence										
Constant	151.982***	89.693***	88.059***	727.700***	100.936***	81.787***	87.451***	70.213***		95.043***
	[28.499]	[23.263]	[24.538]	[98.314]	[26.096]	[24.091]	[23.520]	[25.855]		[23.528]
Observations	1742	1737	1737	732	1737	1707	1737	1737		1737
Number of countries	64	63	63	47	63	63	63	63		63

Standard errors in brackets

* significant at 10%; ** significant at 5%; *** significant at 1%