

The Political Determinants of FDI in Developing Countries

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Summary

- Research question: effect of political institutions on FDI flows
- Literature: evidence inconclusive
- Argument
 - ▶ Need to distinguish between different types of FDI
 - ▶ Need to focus on structural elements of political system
- Research design: analysis of sector-level FDI flows 1983-2003
- Result: support both parts of argument

Literature: two views

- View 1: MNCs attracted to authoritarian regimes (Huntington/Dominguez 1975, Evans 1979, Haggard 1990)
 - ▶ Shield from popular demands
 - ▶ Ability to enact efficiency-enhancing reforms
- View 2: Democracy better environment for FDI (Lipset 1960, North/Weingast 1989, Olson 1993)
 - ▶ Security of property rights
 - ▶ Political stability

Literature: empirical tests inconclusive

- Preference for authoritarian regimes
 - ▶ Resnick 2001, Tuman/Emmert 2004
- Preference for democratic regimes
 - ▶ Rodrik 1996, Harms/Ursprung 2002, Jensen 2003
- No clear relationship between regime type and FDI
 - ▶ O Neal 1994, Li/Resnick 2003, Büthe/Milner 2004

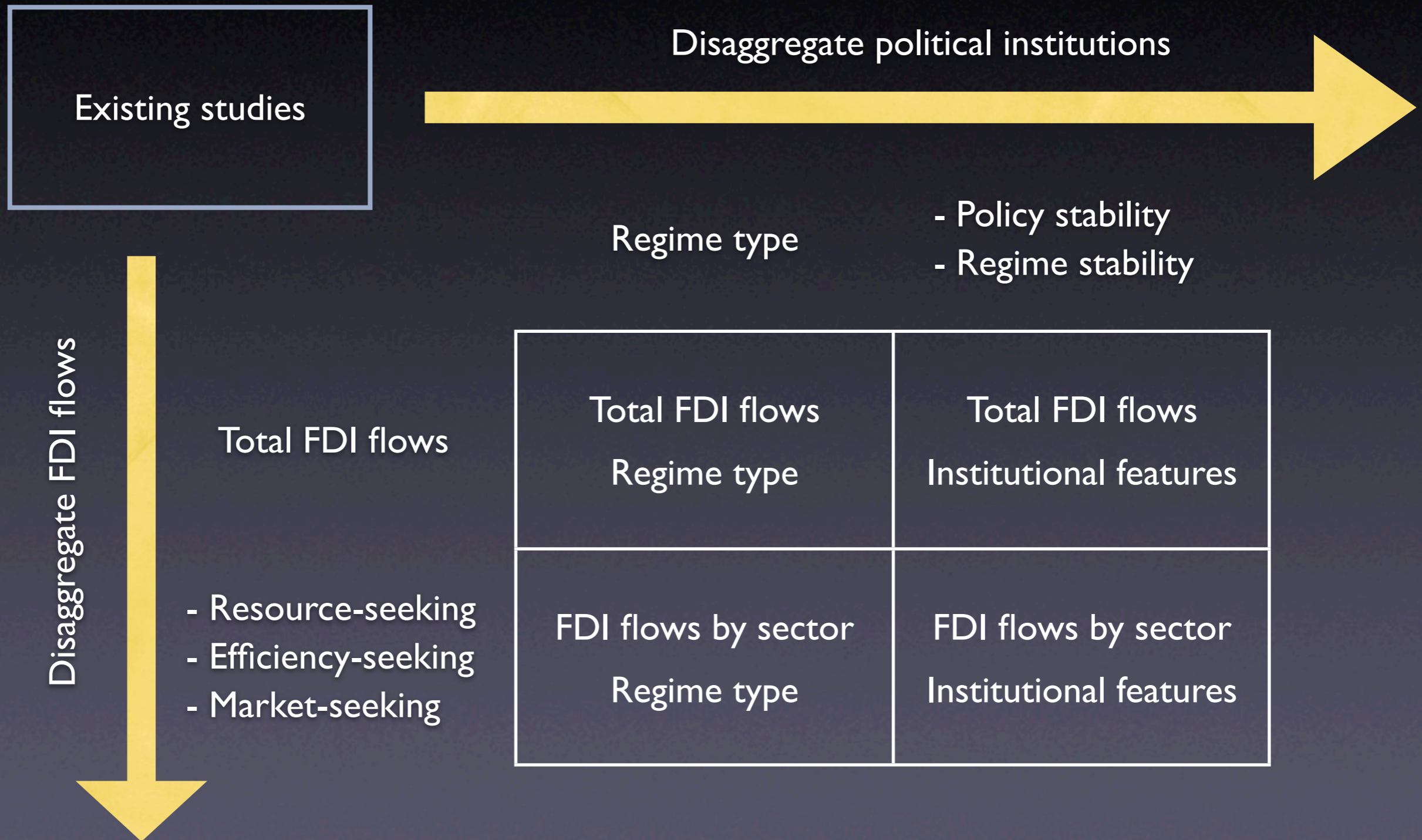
Argument: part I

- Literature does not distinguish between different types of FDI
- Link between regime type and FDI operates on industry-level
- Three different types of FDI
 - ▶ Resource-seeking
 - ▶ Efficiency-seeking
 - ▶ Market-seeking

Argument: part 2

- Regime type fails to capture key political determinants of FDI
- Specific structural characteristics of political system driving MNC investment decisions
- Key factor affecting MNC location: political stability
 - ▶ Policy stability
 - ▶ Regime stability

Analytical Strategy



Dependent variable: data sources

Data source	WDI	UNCTAD	OECD	BEA
FDI source	World	World	OECD	U.S.
Total inflows: OECD	X	X	X	X*
Total inflows: Non-OECD	X	X	X*	X*
Sector inflows: OECD		X**	X	X*
Sector inflows: Non-OECD		X**		X*
T	1970-2004	1970-2004	1982-2004	1983-2004
N	164	184	28	57

FDI destination

* Inflows from country A reported by country B approximated by outflows to B reported by A.

** Not in public domain. Data coverage more limited than for total inflows.

Dependent variable: FDI motive

- Resource-seeking FDI
 - ▶ Primary sector
- Efficiency-seeking FDI
 - ▶ Manufacturing sector
- Market-seeking FDI
 - ▶ Service sector

Note: manufacturing FDI combines efficiency-seeking and market-seeking motivations. The paper classifies manufacturing industries based on their primary motivation and estimates separate models for each group.

Independent variables: hypotheses

	Resource-seeking	Efficiency-seeking	Market-seeking
Economic			
Natural resources	+		
Labor cost		-	
Education		+	
Trade barriers		-	+
Country size			+
Level of development			+
Political			
Regime type	-		
Policy stability		+	+
Regime stability	+	+	+

Additional controls: capital account restrictions, inflation, infrastructure

Model specification

- Cross-sectional analysis
 - ▶ 1993-2003 average
 - ▶ Robust S.E.
- Panel analysis
 - ▶ 1983-2003
 - ▶ Fixed effects
 - ▶ Robust S.E. clustered at country level
 - ▶ Instrumental variables

Results: cross-sectional analysis

Economic variables	Total	Primary sector	Manufacturing sector	Service sector
Natural resources	-	+	-	-
Labor cost			-	
Education				+
Trade barriers	-		-	
Country size	+		+	+
Level of development	+		+	+

Results: cross-sectional analysis

Political variables	Regime type	Policy stability	Regime stability
Model 1	Included	Not included	Not included
Total FDI flows	+		
Primary sector	-		
Manufacturing sector	+		
Service sector	+		
Model 2	Included	Included	Included
Total FDI flows		+	+
Primary sector			
Manufacturing sector			+
Service sector		+	+

Open issues

- Limited variation of political variables over time
- Missing data: sector-level FDI, labor cost