REGIME TYPE, RIGHTS, AND FOREIGN DIRECT INVESTMENT IN LATIN AMERICA

A Brief Comment

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Biglaiser and DeRouen (2006)[1] have provided a thorough examination of the effects of different types of economic reforms on flows of foreign direct investment (FDI). Their main finding—that economic reforms were generally unsuccessful in generating inflows of FDI during the time series—will undoubtedly generate further discussion about neoliberalism in Latin America. Although the authors' focus is on economic reform, they also devote considerable attention to the significance of "good governance" variables, including the effects of political regime type. Biglaiser and DeRouen's (2006) paper adds to a growing number of studies that have produced conflicting findings regarding the effects of regime type and/or rights and liberties on FDI.[2] Given the conflicting results in the literature, and the policy significance of the issue, a brief commentary on the question of regime type, rights, and FDI in Latin America (and in other developing areas) is warranted.

One problem in the literature is that researchers frequently employ measures of regime type that may not adequately capture cross-sectional differences in rights and civil liberties in Latin America. Similar to previous studies, Biglaiser and DeRouen (2006) use the Polity IV data set (Marshall and Jaggers 2002) as a measure of authoritarianism and democracy in recipient countries. The Polity data focus primarily on constraints faced by the executive, the degree of competition and openness in executive recruitment, and political competition in a

1. "Economic Reforms and Inflows of Foreign Direct Investment in Latin America," by Glen Biglaiser and Karl DeRouen, Jr. appeared in *LARR* 41, no. 1 (February 2006), 51-75.

2. See, for example, Daude, Mazza, and Morrison (2003), Li and Resnick (2003), Tuman and Emmert (2004), and Biglaiser and DeRouen (2006). Many other studies could be cited here.

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regime. Civil liberties and rights are not assessed separately but rather quite indirectly as part of broader rating of group, party, and electoral competition (Marshall and Jaggers 2002, 78–81). There is a potential drawback here. Decision makers in multinational firms may respond more to the degree to which certain liberties and political rights are present in a recipient country—such as freedom of the press or the associational rights of workers and peasants—than to the degree of overall electoral and political competition.[3] To this extent, given the question of how well the Polity data capture cross-sectional differences in rights and liberties, statistical analyses that rely exclusively on the Polity data may be missing an important determinant of FDI flows. To address this issue, researchers using Polity should also conduct sensitivity analyses where the statistical models are estimated with direct measures of civil liberties and political rights.[4] At least one study (Tuman 2005) conducting sensitivity analyses found that in fifteen Latin American countries for the period of 1981 to 1996, Polity had no effect while abuse of civil liberties and political rights (as measured by Freedom House [2004] and the Political Terror Scale [Gibney 2004] data) had a positive and statistically significant effect on inflows of U.S. FDI.[5]

3. One should not assume that the Polity data are necessarily associated with other indices of civil liberties and political rights (e.g., Freedom House 2004]. The strength of the correlation between Polity and other indices may vary depending upon the "country/year" observations and region included in the data set; studies using data sets with unbalanced panels should be particularly mindful of this issue. Moreover, as Smith (2005: 263–84) has shown, although many regimes in Latin America experienced improvements in the area of political competitiveness (i.e., provision of free and fair elections) between 1972 and 2000, there were on-going problems in the area of civil liberties and political rights during the same period. For these reasons, the safest approach for studies focusing on Latin America is to conduct a thorough sensitivity analysis, estimating models with the Polity data and, in separate trials, with other data on civil liberties and political rights.

4. Li and Resnick (2003) conducted this type of sensitivity analysis by comparing the Polity and Freedom House data in a global study of FDI flows. Regrettably, the authors used a measure that pooled FDI flows from firms from many different countries (World Bank, n.d.). As I explain below, using this type of measure of FDI fails to control for the possibility that firms based in different home countries may vary in their reaction to levels of democracy, rights, and civil liberties in recipient countries.

5. The study utilized a data set with balanced panels; the time series started in 1981 because this was the first year for observations in the Political Terror Scale (Gibney 2004). The same political and economic variables reported in Tuman and Emmert (2004) were used as controls in the model. Separate trials were then conducted using the Polity data (a recipient's autocracy score was subtracted from its democracy score, lagged by one year), Freedom House (the mean of a country's civil liberties and political rights abuse score, lagged by one year; higher score indicate more abuse), and the Political Terror Score (the mean of a recipient's political terror score lagged by one year; the PTS data are based upon assessments of political imprisonment, state-sanctioned torture and murder, and the rule of law from reports provided by the U.S. State Department and Amnesty International, with higher scores indicating more abuse).

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A second issue has to do with the measure used for FDI flows. A number of recent studies, including Biglaiser and DeRouen (2006), use data from the World Development Indicators (n.d.) that pool observations of FDI flows from firms based in many different "home" countries. The basic problem with this technique is the failure to control for firm behavior that may be a product of distinctive national differences.[6] Multinational firms based in different countries may react in quite varied ways to the type of regime and degree of rights and liberties in recipient countries.[7] Indeed, a number of factors in the home country of the multinational firm—ranging from partisan control, a tradition of bureaucratic guidance in investment decisions, the structure of corporate governance, or the relative strength of social movements—can be expected to influence the incentive structure facing corporate decision-makers, possibly making firms from some countries more sensitive to democracy, rights, and civil liberties in recipients than other firms. For these reasons, it is preferable to estimate models using, for example, separate measures of U.S., Japanese, and French FDI in Latin America as opposed to a single measure that pools FDI from firms based in many different countries.

Although many other points could be discussed here, attention to the methodological issues raised in this brief comment will, in my judgment, not only improve the quality of the future research on FDI in Latin America but also help resolve some of the conflicting empirical findings with regard to regime type, rights and FDI.

6. Data on FDI flows from U.S. and Japanese firms are widely available from government sources, for example. In addition, the OECD published data on outward FDI flows from firms based in each OECD member.

7. See Pauly and Reich (1997), Tuman and Emmert (1999; 2004) for examples of a divergence in the FDI behavior of U.S., Japanese, and German multinational corporations.

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