Democratization

ISSN: 1351-0347 (Print) 1743-890X (Online) Journal homepage: https://www.tandfonline.com/loi/fdem20

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To cite this article: Chungshik Moon (2019) Political institutions and FDI inflows in autocratic countries, Democratization, 26:7, 1256-1277, DOI: 10.1080/13510347.2019.1627520

To link to this article: https://doi.org/10.1080/13510347.2019.1627520

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DEMOCRATIZATION
2019, VOL. 26, NO. 7, 1256–1277
https://doi.org/10.1080/13510347.2019.1627520

Political institutions and FDI inflows in autocratic countries*

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ABSTRACT
Why do some autocratic countries attract more foreign direct investment (FDI) than others? Surprisingly, few studies have explored the considerable variation in FDI inflows to non-democratic countries. In this article, I argue that non-democratic countries with seemingly democratic political institutions, such as elected legislatures, attract more FDI inflow than others. This is because these institutions can (1) reduce the transaction costs of investment activities due to the relative transparency of the policy-making process, and (2) act as veto players, making the existing market-friendly policy changes difficult, and thus, promising a more stable investment environment. My empirical results support the main expectation that autocratic countries with legislatures attract more FDI than other autocratic countries, and the institutions' effects are conditionally modified by the quality of market protecting institutions.

ARTICLE HISTORY Received 28 August 2018; Accepted 27 May 2019

KEYWORDS foreign direct investment; FDI; autocratic regimes; autocratic legislatures; property rights; MNCs; power sharing

Introduction

Since the 1980s, the global economy has been liberalized by an increase in free trade and international investment. The growth of foreign direct investment (FDI) is particularly remarkable. The number of multinational corporations (MNCs) increased from approximately 20,000 in the 1980s to more than 80,000 by around 2010, and the amount of FDI grew about tenfold during the same period, from US$ 180 billion to 1.8 trillion.[1] As FDI is intended to provide host countries with better opportunities to access abundant foreign capital, along with advanced technologies and marketing skills, studying the conditions that facilitate FDI has concomitantly become a major concern for both policymakers and scholars.

Aside from the general economic determinants, political scientists have primarily focused on how domestic conditions such as domestic political instability, veto players, democratic institutions, and property rights institutions affect the likelihood

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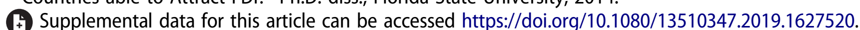
*An earlier version of this article was presented at the 4th Annual Conference of the Australian Society for Quantitative Political Science, University of Melbourne, 9 December 2015. The article draws in part on chapter 3 of Chungshik Moon, "Credible Commitment Institutions and Foreign Direct Investment: How are Autocratic Countries able to Attract FDI?" Ph.D. diss., Florida State University, 2014.


Supplemental data for this article can be accessed https://doi.org/10.1080/13510347.2019.1627520.

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of attracting inward FDI.[2] This literature has found that that democratic countries, on average, provide better investment environments than non-democratic ones because their domestic institutions are better designed to protect foreign assets.[3]

However, FDI in autocracies has received limited scholarly attention. While certain autocratic countries, such as China and Singapore, receive immense amounts, others suffer from a lack of foreign capital. The variation of FDI inflows across autocratic countries is far greater than across democracies. Figure 1 presents a distribution of (logged) FDI inflows to the developing world (non-OECD countries), from 1970 to 2008. While the median value of FDI inflows to democratic countries is higher than to autocracies, there is greater variation among autocratic countries.[4] Given the academic consensus that MNCs are more likely to invest in countries that can credibly commit to protecting foreign assets, investment in autocratic countries, which are usually considered to lack such credibility, is an interesting puzzle. Under what conditions do certain autocratic countries attract more FDI than others?

Existing literature, for example, argues that autocracies with strong property rights are likely to attract more FDI and personalist dictatorships are likely to allow monopoly rent extraction, thus attracting fixed-type FDI.[5] Similar to the existing works, this research also focuses on the role of domestic institutions in autocratic regimes. However, not only does this research examine a general determinant of FDI in autocracies, but it also specifies a condition under which the institutions work (or not) as anticipated.

In this article, I seek to explain the variation in FDI inflows by investigating the differences in political institutions that exist in autocracies. Although there are many different types of political institutions in autocracies, the main concern of this research is the role of democratic institutions such as elected legislatures in autocracy, which I

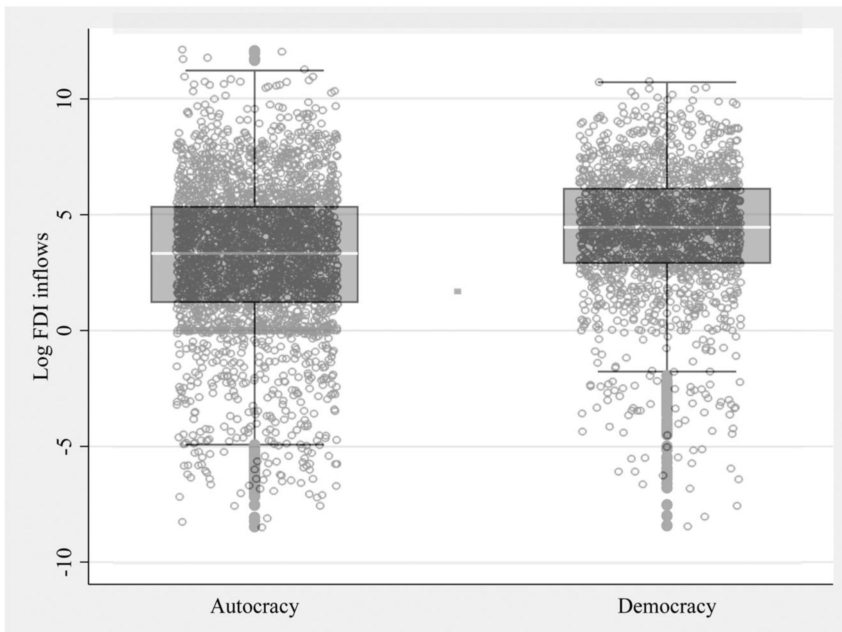

Figure 1. FDI inflows over regime type (non-OECD countries, 1970–2010).

label autocratic political institutions. I expect that autocracies with legislatures attract more FDI inflows in general, and further argue that the institutions' effects are conditioned by the quality of other institutions relevant to commitment decisions, such as property rights. Autocratic regimes are relatively closed compared to democratic ones and are subject to ex-post policy changes. Elected legislatures can increase the transparency of the decision-making process, and thus, reduce transaction costs for MNCs. In addition, autocratic political institutions can act as veto players, impeding policy change, and thereby affording more stable investment environments. Finally, I expect that the policy stability stemming from multiple veto actors is more favoured by MNCs when the host country has strong property rights institutions, since an elected legislature further strengthens the credibility of existing property rights institutions.

My empirical analysis, testing all autocratic countries from 1970 to 2008, supports this expectation. Using Gandhi's measure of autocratic institutions,[6] I find that autocratic countries with legislatures are likely to attract more FDI inflows than those without. Furthermore, the results suggest that the institutions' effects are modified by the strength of property rights institutions. The legislatures' effects on FDI inflows to autocracies are not only positive, but their size also increases with the strength of property rights institutions.

In the subsequent section, I review the literature examining political determinants of FDI and the variation of political institutions in autocracies, and subsequently explore how political institutions affect political/economic performance in autocracies. I then examine the causal mechanisms through which legislatures can help autocratic host countries attract more FDI, and I discuss my research design and empirical analysis, before concluding.

Domestic political determinants of FDI

FDI differs from other types of foreign investment (e.g. portfolio) in that it involves direct ownership by foreign investors, has a long-time horizon, and is a relatively fixed asset. These characteristics make FDI politically sensitive to time-inconsistency issues as it is subject to *ex-post* government policy changes and expropriations. Studies on the political determinants of FDI, therefore, focus on the commitment issue or, more generally, how to provide foreign investors with a better investment environment, which reduces the costs of doing business.[7]

Scholars have greatly focused on the institutional features of host countries. Henisz, for example, argues that host countries with higher numbers of veto players can provide a more stable policy environment, and finds that on average they receive larger amounts of FDI.[8] Robert provides a more sophisticated argument that more veto players attract FDI only in a host country with an FDI friendly policy environment.[9] Regime type also matters. Previous studies argued that authoritarian regimes attract more FDI.[10] However, recent empirical studies tend to prove that MNCs favour democratic institutions.[11]

While the positive association between democracy and FDI inflows is received wisdom among scholars, the variation in FDI inflows to autocratic countries, although commonly observed in the real world, has received limited academic attention. Moon argues that autocratic countries with long time horizons are more likely to provide strong property rights institutions and thereby attract more FDI.[12] Wright and Zhu

find that personalist dictators attract more FDI in the primary sector because they have more policy autonomy to allow MNCs market monopolization.[13] Considering the growing body of literature that focuses on the institutional differences of political systems in autocratic regimes, the political institutions' effect on FDI in autocracies also deserves examination.

Political institutions in autocratic countries

Increasing studies have examined the institutional differences between autocratic regimes and how they lead to distinctive political economic outcomes.[14] One approach is to examine the role of democratic institutions in autocracies, such as parties and legislatures. While the traditional view regarded these institutions as no more than window-dressing,[15] scholars now argue that they are designed to serve certain political purposes, and that variation in political institutions can lead to distinctive political outcomes.

Gandhi and Przeworski argue that these institutions are the products of cooptation in which rulers exchange policy concessions in return for political support from opposition groups.[16] Autocrats care about their own survival, and the threats usually come from ruling elites and mass mobilization. However, dictators cannot rely solely on repressive means to prevent challenge but need voluntary cooperation in areas such as domestic investment, which can hardly be enforced. The cooptation argument suggests that autocrats have to solicit cooperation from oppositions and further contends that providing legislative seats can be observed as a policy concession by which autocrats can appease domestic threats and induce cooperation.

Magaloni, Gehlbach and Keefer, and Boix and Svolik have a slightly different view.[17] They agree with the cooptation hypothesis to the extent that those institutions are created to serve political purposes; yet they underscore how the institutions can solve the commitment problem. While the cooptation argument is convincing, it is unclear why autocrats would not want to eliminate challengers once potential threats are appeased with policy concessions. That is, a simple exchange of concessions does not amount to a credible commitment not to expropriate.

Magaloni states that parties and elections are a way of addressing the commitment issue, facilitating power sharing between the ruler and rivals.[18] She argues that autocrats can solve the commitment problem by delegating power to political parties in which rivals have access to positions of power and benefits. Gehlbach and Keefer examine how dictators can use ruling parties to address the commitment problem.[19] They argue that autocrats can increase the credibility of power-sharing by institutionalizing ruling parties in which political elites coordinate collective action against abusive rulers; by making coordinated rebellion possible, the power-sharing promise becomes more credible under these institutions.

Boix and Svolik mention the purpose of political institutions as alleviating an information problem between autocrats and ruling elites.[20] While both autocrats and elites have a strong incentive to make a commitment to joint ruling – hence power-sharing – this motivation is threatened by the fact that the ruler has more private information on national resources and benefits, and more potential for abusing his allies. Political institutions can solve this asymmetric information problem by providing formal places where transparent interactions can be observed. Thus, the purpose of creating formal institutions is to complement the credibility of commitment to power-sharing.

While the theoretical differences between cooptation and power-sharing arguments are obvious, they share the common premise that rulers are constrained by political rivals through these institutions. Focusing on this constraining feature, scholars explore the link between political institutions and economic performance in autocracies. As North and Weingast note, one possible link is that government expropriations are limited by other political actors through the legislature and this constraint, in turn, promotes domestic investment.[21] Wright suggests that autocratic governments can create binding legislatures to encourage domestic investment, particularly when they are not endowed with natural resources.[22] Gehlbach and Keefer suggest that an institutionalizing ruling party supplies a credible commitment not to expropriate political elites.[23] The implication of this argument echoes North and Weingast: that credible commitment can encourage private investment.[24] Gandhi proves that autocracies with multiparty legislatures tend to display higher growth rates, and concurs with the view that autocratic political institutions can provide a somewhat credible commitment.[25]

The missing link here is the lack of literature examining the relationship between autocratic political institutions and FDI. Not only do legislatures in autocracies attract domestic investment and affect economic growth, but they can also shape FDI inflows. As yet, we know little of the effects they have on MNCs' investment decisions.[26]

Autocratic political institutions and FDI inflows

FDI creates an interaction between foreign investors and host governments. That is, the host governments' preferences, as well as those of foreign investors, affect the level of inflows. First, the autocratic governments' preferences are influenced by the extent to which they depend on autocratic political institutions. As scholars posit, the political fates of autocratic leaders usually rely on certain constituencies, and the extent to which autocrats are accountable to domestic groups can vary depending on their political system. In the previous section, we saw that the reason for creating legislatures is to secure the regime against potential political threats from the inside. Both the cooptation and power-sharing arguments assume that meeting the demands of political elites is a key to maintaining a stable regime. Autocratic governments with legislatures, then, should be more accountable to the groups with which they share power, compared to the personalist type of autocrat or military dictators, who are usually supported by relatively small size of military juntas.

This variation in accountability also implies that autocratic governments would have different incentives in distributing economic benefits, including those from FDI inflows. FDI can be a source of enormous economic benefits and privileges to both an autocratic ruler and political elites. Not only do FDI inflows have positive externalities, creating GDP gains and jobs at the country level, but they may also have instrumental value for autocrats as a means of distributing economic returns and satisfying political elites.[27] Hence, autocrats with legislatures are more likely to make an effort to promote FDI inflows as a means of economic distribution. That is, holding the domestic economy constant, autocrats will shift their interests towards FDI as the need for economic distribution increases.

In addition to the autocrats' preferences, as discussed above, autocratic countries with legislatures can be attractive to MNCs for further reasons. First, legislatures, in particular, are useful to foreign investors as they allow MNCs to access inside information

of an autocratic regime: in other words, increasing their transparency. Rosendorff and Shin posit that transparency can reduce future transaction costs resulting from an uncertain political environment.[28] By allowing foreign investors to observe state behaviours, they further argue, host countries can build a favourable reputation that will cement their commitment to the investment climate.

Autocratic regimes, unsurprisingly, are relatively closed compared to democratic ones. In the latter, people can use various political institutions to debate government performances and exchange opinions on policies. Legislatures are prisms through which citizens can observe current political agendas. Autocratic regimes usually lack these institutions and decision-making tends to occur behind closed doors. Not only does this secrecy foster government corruption and the possibility of expropriation, as Boix and Svolik assert, it also increases uncertainty in the investment environment.[29] Autocratic political institutions can provide some easily observable, albeit limited, information.[30] For instance, foreign investors can follow political debates and bargaining outcomes regarding the rules and regulations that govern foreign investment, or they may be able to predict more accurately whether the host government will resort to illegal means to increase their returns.

Second, legislatures in autocracies can be valuable to foreign investors as veto players. By constraining government policy changes, they contribute to providing a stable investment environment. Tsebelis argues that veto players promote policy stability; with more political actors involved in the decision-making process, the diversity of preferences makes policy change less feasible.[31] Building on Tsebelis, Henisz argues that if MNCs enter a host country expecting that an initial policy position will remain unchanged, they will accordingly increase FDI inflows.[32] The same logic can be applied to autocratic regimes with legislatures, regarding economic policies. Existing literature argues that not all members in the host country benefit from FDI; it creates domestic winners and losers.[33] In addition, even political elites in the winning coalition can have varied preferences regarding market-friendly economic policy because not all the members of the winning coalition will benefit from FDI depending on the differences of sectoral ownerships or individual relationships with the government; "FDI income may lead to contestants among political elites, between beneficiaries and others."[34] Thus, if there are multiple veto players in autocratic countries, their heterogeneous preferences on FDI are likely to hinder policy changes. Similarly, Li indicates that there is considerable variation in the numbers of veto players among autocracies and that higher numbers are negatively associated with the FDI expropriation rate.[35]

H1. Autocratic countries with legislatures are likely to attract more FDI inflows.

While stability can be a favourable signal to foreign investors as a window for forecasting the future, if the current policies or rules are not market-friendly, that stability may be observed as bureaucratic rigidity, rendering the host government less likely to adopt market-friendly institutions in the future. Thus, in addition to the direct effect, I further expect that legislatures in autocracies are likely to attract more FDI when market-friendly institutions, such as property rights institutions, exist in the host country.

Among various market-friendly policies, property rights institutions (and legal enforcement mechanisms) provide a direct assurance to MNCs, and thus are essential for attracting FDI inflows.[36] Strong property rights institutions not only protect foreign assets from state expropriations but also provide a binding legal enforcement mechanism.[37] In addition, as discussed above, even political elites in autocratic regimes may

have varied preferences about FDI as the FDI benefits may not be evenly distributed; thus, if an autocratic country with many veto players employed market-friendly policies favoured by MNCs, the market-friendly policy would be less likely to change.

Combining these two arguments provides interesting predictions. I expect political institutions in autocratic regimes to have, on average, positive effects on FDI inflows, and I further predict that these institutions' effect will be stronger in countries with better market institutions; autocratic countries with strong property rights institutions and political institutions that make policy changes less feasible should be more favoured by MNCs.[38] Roberts makes a similar point in that democracy's positive effect on FDI is largely because of the combination of domestic political constraints and a market-friendly economic policy that is being constrained.[39]

What about countries that have political institutions but lack strong property rights protection? When scholars examine the relationship between veto players and FDI inflows, they usually focus on the policy stability that results, not in the direction or the content of that stability. In these circumstances, veto players and the policy stability that they induce may not be a welcome signal for MNCs. That is, legislatures do not necessarily have positive effects on FDI inflows when the market institutions of the host countries are weak.[40] On one hand, the positive effects of the institutions may be almost equally balanced by weak market institutions. On the other hand, institutional inflexibility can be observed as a negative signal to MNCs.

H2. The effect of legislatures on FDI inflows is likely to be stronger among autocratic countries with strong property rights institutions. However, the institutions have no positive effect on FDI inflows when the countries have weak property rights institutions.

One may question if there are any alternative causal paths through which legislatures and parties in autocracies can affect FDI inflows. First, as North and Weingast suggest, institutionalized power sharing can lead to the development of property rights institutions.[41] The presumption here is that political institutions can constrain predatory behaviour by the government, thus providing better protection to investors. This is the most commonly suggested mechanism explaining the correlation between autocratic legislatures and economic growth.[42] Given that FDI is a relatively fixed asset and is subject to *ex-post* commitment violations, strong property rights institutions can credibly commit to its protection. If legislatures can produce strong protection for foreign properties, we would see higher levels of FDI flowing into autocracies with legislatures. However, this explanation is based on the somewhat questionable assumption that legislatures in autocracies represent the interests of MNCs. Legislatures represent the interests of political elites, who in autocratic countries are usually capital owners. Through the legislatures, they can collectively coordinate to monitor and check predatory behaviour by the ruler, to this end strengthening property rights.[43] They can then make domestic investments that are necessary for economic growth. The idea that the legislatures act on behalf of the interests of foreign investors is less convincing. We have limited reason to believe that political institutions in autocracies will protect the rights of foreign investors equally to domestic rights, thus attracting FDI.

Another possibility is the correlation between the presence of legislatures and regime stability. The cooptation argument, for example, explains that an autocratic government provides policy concessions in the form of institutions to bargain with political opponents to address potential challenges.[44] The power-sharing argument is similar: an autocrat's willingness to share power is credible depending upon the level of

threat the government faces.[45] Both arguments rely on the assumption that considerable domestic challenges exist in the regime, and that by appeasing them autocrats can lengthen their tenures. On this reasoning, scholars argue that power-sharing institutions are positively associated with regime stability and autocratic tenure,[46] and that time horizons can affect the amount of FDI that host countries receive.[47] It is also possible, therefore, to expect that political institutions shape autocrats' time horizons and, in turn, increase FDI inflows. In the next section, I control for both property rights institutions and time horizons to account for two alternative causal mechanisms discussed above to test the political institutions' effects on FDI inflows more directly.

Research design

I employ a time-series cross-sectional design that covers 86 authoritarian countries (see Online Appendix Table A2). The temporal domain covers the period 1970–2008 because of joint data availability. Since panel data commonly experience heteroscedasticity, cross-sectional correlations, and autocorrelations in disturbances, I use a Driscoll-Kraay estimator that produces consistent and robust standard errors. A Driscoll-Kraay standard error structure is assumed to be heteroskedastic, autocorrelated up to some lag, and possibly correlated between the groups (panels). These standard errors are robust to general forms of cross-sectional (spatial) and temporal dependence when the time dimension becomes large.[48] Note that my theory is more concerned with a cross-sectional comparison – comparing the performances of autocratic countries with and without legislatures. Thus, I include year-fixed effects to account for a potential time-trending issue (e.g. the global financial crisis) that may affect FDI.[49]

My key dependent variable is the amount of FDI. While some studies use a standardized FDI measure (e.g. FDI as a percentage of GDP), I did not use a scaled measure for two reasons. First, it is conceptually different from what this research attempts to capture. The standardized FDI captures "the relative importance of FDI inflows to a country's national economy or the country's openness to FDI inflows."[50] FDI is an investor's decision; they would not discount their investment risk because the size is relatively small to the size of a host country's economy. That is, the absolute size of the investment is a more accurate investment decision measure, not the host country's relative reliance on FDI. Second, as Allee and Peinhardt note, the standardized FDI measure could lead to artificially large correlations with variables on the right side of the regression equation.[51] Even if GDP is not controlled explicitly on the right side of the equation, control variables can affect both the denominator (e.g. GDP) and the numerator (e.g. FDI), jointly or independently, which makes the inference uncertain. The use of a standardized measure "does not allow us to separate the respective effects of an independent variable on FDI and GDP."[52] Thus, I use FDI inflows as a key dependent variable.[53] FDI variables come from the United Nations Conference on Trade and Development (UNCTAD). I take a natural log to FDI inflow to deal with skewness. Since logged FDI inflow may suffer from zero and negative observations, I use the following commonly used transformation to handle these values.[54]

$$\text{If FDI} \geq 0 \text{ then Log FDI} = \text{Log}(1 + \text{FDI}),$$
$$\text{and if FDI} < 0 \text{ then Log FDI} = -\text{ Log}(1\} + |\text{FDI}|)$$

As a measure of autocratic political institutions, I use the political institution data

employed by Gandhi.[55] She codes autocratic institutions into three categories: 0 for non-institutionalized dictatorship, 1 if the incumbent party occupies all legislative seats, and 2 if there is a multiparty legislature. As my argument concerns the role of power-sharing and constraints imposed by other actors in decision-making processes, I code the variable, *Autocratic Political Institutions,* as a dichotomous variable: 1 if a country has a multi-party legislature and 0 otherwise.[56]

To test H2, I need to measure property rights institutions. I use Contract Intensive Money (CIM).[57] CIM is one of the most commonly used measures of property rights and judicial strength, which calculates the ratio of non-currency money to the total money supply.[58] As a robustness test, I use the latent judicial independence measure created by Linzer and Staton and property rights measure by International Country Risk Guide (ICRG).[59]

I also include autocrats' time horizons to test whether the main findings are affected by an alternative mechanism – regime stability – as discussed in the previous section. Theoretically, time horizons measure leaders' expectations on the future security of tenure. I use a time horizon variable created by Wright, which calculates the predicted probability of regime failure: the higher the value, the shorter the time horizons.[60]

I control for economic and political factors that may affect MNCs' investment decision: *Development* (GDPpc), *Market Size* (logged population), *Growth Rate* (GDP growth rate), *Oil Rent* (% of GDP), *Government Consumption* (% of GDP), *Domestic Political Conflict* (Banks's Conflict Index), and *Bilateral Investment Treaty* (*sign BIT* or not).[61] As expected, FDI inflows would increase when host countries have a large domestic market and experience rapid economic development, as they have more purchasing power. Scarce natural resources, such as oil, may attract location-specific investment.[62] While excessive government intervention may distort the distribution of resources, investment in national infrastructure can be conducive to foreign investment.[63] Violent political events, such as military coups, riots, and revolutions, are likely to increase the overall transaction costs of doing business, thus affecting FDI inflows negatively.[64] Lastly, signing BITs can increase FDI inflows, as they provide an institutional device that protects foreign assets from potential government expropriation.[65] I use the World Bank's World Development Indicators for all controls other than political conflict and BITs.[66] For these, I use, respectively, a weighted conflict index from Arthur Banks' Cross-National Time-Series Data Archive[67] and the International Investment Agreements (IIAs) database from the United Nations Conference on Trade and Development (UNCTAD).[68]

My main models are as follows:

(1) FDI inflows = β_1 Autocratic Political Institutions + β_2 Property Rights Institutions + controls
(2) FDI inflows = β_1 Autocratic Political Institutions + β_2 Property Rights Institutions + β_3 Autocratic Political Institutions * Property Rights Institutions + controls

Model (1) is an additive model that captures the autocratic political institutions' independent effect on FDI inflows. Since I expect autocratic countries with political institutions to attract, on average, more FDI inflows than other autocratic countries, β_1 should be positive and significant. In Model (2), I include the interaction term between the political institutions and property rights institutions variables. I argue that the effect of political institutions' effect will be much stronger among countries

with better economic policies. Thus, the interaction term (β_3) should be positive. See Table 1 for sample summary statistics.

Empirical results

Table 2 reports the main empirical findings. Model 1 includes the autocratic political institutions along with a set of control variables. Models 2 and 3 further control for the property rights and time horizons variables. Finally, Model 4 presents the results of the interaction model to test H2. In all models, the level of development, market size, growth rate, government consumption, and BITs variable have positive and significant effects on FDI inflows.

From Model 1 to 3, countries with the institutions attract more FDI inflows. After controlling for the time horizons and property rights variables, the coefficient of the political institutions variable is positive and statistically significant at the 1% level, supporting H1. The findings also provide empirical evidence that legislatures have an independent effect on FDI inflows (Model 3), which may be distinct from North and Weingast.[69] While the size of the effect of autocratic institutions on FDI inflows decreases as the property rights and time horizon are included, the autocratic political institutions variable remains significant. Substantively, the autocratic countries with political institutions would attract 68% more FDI inflows than countries without such institutions.

This finding displays interesting dynamics between the three variables regarding the aforementioned alternative explanations. First, both property rights and political institutions remain significant regardless of the inclusion of the other variable. Thus, each has its own independent effect on FDI inflows. I argue that political institutions can attract FDI inflows in more ways than property rights institutions can command. The results here clearly support my contention that political institutions and property rights institutions have different causal mechanisms. Second, time horizons may matter, but only indirectly. If political institutions affect FDI inflows by providing regime stability, we would observe the political institutions variable turning insignificant once we control for time horizons. They do not, thus, the finding confirms that the effects of autocratic political institutions on FDI inflows are not derived from the regime stability path. The second alternative mechanism, then, is no longer a concern.

Table 1. Summary statistics.

Variable	N	Mean	Std. Dev.	Min	Max
Logged FDI inflow	1770	3.117	2.853	−7.070	10.888
Logged FDI stock	1210	6.256	2.439	0.000	12.339
Autocratic political institutions	1770	0.379	0.485	0.000	1.000
Single party	1770	0.294	0.456	0.000	1.000
CIM	1648	0.720	0.150	0.243	0.996
LJI	1770	0.223	0.148	0.010	0.908
Time horizon	1770	0.041	0.040	0.000	0.358
Development	1770	2147.188	3509.109	60.306	34090.060
Market size	1770	15.977	1.374	13.036	20.977
Growth rate	1770	3.922	7.229	−51.031	106.280
Government consumption	1770	10.934	9.244	0.976	68.089
Conflict index	1770	959.183	1878.997	0.000	26187.000
Sign BIT	1770	0.251	0.434	0.000	1.000
Oil rent	1770	5.612	12.156	0.000	88.804

Table 2. Autocratic political institutions on FDI inflows.

DV: FDI inflows	Model 1	Model 2	Model 3	Model 4
Autocratic political institutions	0.797***	0.722***	0.680***	−1.037
	(0.238)	(0.230)	(0.214)	(0.703)
CIM		4.150***	4.059***	3.202***
		(0.571)	(0.621)	(0.614)
Autocratic political institutions*CIM				2.311**
				(0.930)
Time horizon			−3.669**	−3.657**
			(1.656)	(1.676)
Development	0.171***	0.111***	0.107***	0.100***
	(0.027)	(0.022)	(0.022)	(0.022)
Market size	0.662***	0.624***	0.635***	0.617***
	(0.084)	(0.083)	(0.082)	(0.084)
Growth rate	0.061***	0.056***	0.053***	0.054***
	(0.008)	(0.007)	(0.007)	(0.007)
Government consumption	−0.686	1.367**	1.508***	1.209**
	(0.542)	(0.585)	(0.566)	(0.551)
Domestic political conflict	−0.012	−0.006	0.010	0.008
	(0.034)	(0.035)	(0.037)	(0.036)
Oil rent	0.012**	0.016**	0.014**	0.015**
	(0.006)	(0.006)	(0.007)	(0.007)
Sign BITs	0.784***	0.711***	0.668***	0.674***
	(0.174)	(0.167)	(0.167)	(0.168)
Constant	−8.288***	0.000	0.000	0.000
	(1.340)	(0.000)	(0.000)	(0.000)
R^2	0.33	0.36	0.36	0.37
N	1648	1648	1648	1648

Note: Standard errors in parentheses *significant at 10%; **significant at 5%; ***significant at 1%.

I turn to Model 4 where I add an interaction term between the political and property rights variables. The interaction term's coefficient is as I predict: it is positive. Once I include the interaction term, the constitutive term, *Autocratic Political Institutions,* turns negative and insignificant, whereas the property rights institutions' coefficient remains the same: positive and significant. However, one should be careful in interpreting interaction models' results. Since the effect of one independent variable on the dependent variable is conditioned upon the change of another variable, each constitutive term's coefficient is less informative. Additionally, the interaction effect's standard error should consider two independent variables' covariance.[70] Thus, to capture the quantities of interest, I plot the marginal effects of autocratic political institutions on FDI inflows (i.e. $\beta_1 + \beta_3$ *Property Rights Institutions)* in Figure 2.

Figure 2 presents the marginal effects of autocratic political institutions on FDI inflows, based on Model 4. The Y-axis represents the estimated marginal effects of autocratic political institutions on FDI inflows as the level of property right institutions changes along the X-axis. I also include kernel density estimation to confirm whether the main findings are present with a non-outlier sample. From the graph, it is evident that the political institutions' effect increases as the value of property rights institutions rises. That is, countries that have autocratic political institutions attract more FDI inflows, particularly when their property rights institutions are strong. This finding supports H2.

Substantively, compared to autocratic countries that lack these institutions, the countries in which such institutions have a presence can attract approximately 63% more FDI inflows when the property rights institutions index is at its mean value

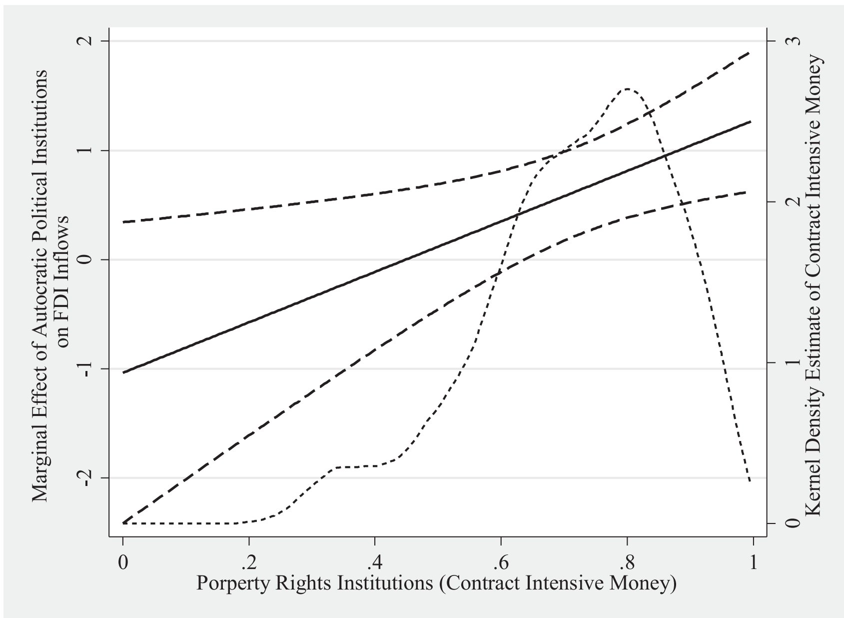

Figure 2. Marginal effects of autocratic political institutions on FDI inflows (Model 4).

(0.72). The size of marginal effects increases to 100% when the property rights index is approximately 0.88, which is one standard deviation above the mean. Additionally, the marginal effects turn significant at the 5% level when the property rights index is greater than approximately 0.64. Under this value, autocratic political institutions do not attract foreign investors. Note that more than 82% of the sample falls above 0.64 on the property rights scale.

I perform several robustness tests in Tables 3 and 4. In Table 3, I report the results controlling for country-fixed effects as a robustness test. The key findings in Table 3 are similar to those presented in Table 2. The independent effect of *Autocratic Political Institutions* is positive and significant (Model 5), which again supports H1. The interaction model is presented in Model 6. The interaction term's coefficient, *Autocratic Political Institutions x CIM*, is positive and the marginal effects are significant. Figure 3 presents the same results as Figure 2; the political institutions' effects are positive and significant in countries with strong property rights institutions, and the size of the effects increases as property rights institutions become stronger, which supports H2. While within-country variations are not the main concern of this research, the presence of within-country effects suggest that once autocratic countries adopt political institutions, they can subsequently expect an increase in FDI inflows. Thus, the findings further bolster the main findings reported here.

Table 4 reports another robustness test, using different measures of key independent variables. The first two columns (Models 7 and 8) use a different measure of property rights institutions, and the other two (Models 9 and 10) present results using an alternative measure of autocratic political institutions. In Models 7 and 8, I use the latent judicial independence measure (hereafter LJI) created by Linzer and Staton.[71] LJI is a latent measure of judicial independence, which relies on various existing indicators of the rule

Table 3. Effects of autocratic political institutions on FDI inflows (country-fixed effects).

DV: FDI inflows	Model 5	Model 6
Autocratic political institutions	0.350**	−0.436
	(0.166)	(0.766)
CIM	2.291**	1.922*
	(0.929)	(1.035)
Autocratic political institutions*CIM		1.093^
		(1.033)
Time horizon	−11.180***	−11.168***
	(3.112)	(3.105)
Development	0.057***	0.050**
	(0.021)	(0.022)
Market size	1.189***	1.227***
	(0.316)	(0.317)
Growth rate	0.038***	0.038***
	(0.008)	(0.008)
Government consumption	1.072	0.800
	(1.982)	(2.013)
Domestic political conflict	−0.066**	−0.068**
	(0.031)	(0.032)
Sign BITs	0.774***	0.773***
	(0.145)	(0.145)
Oil rent	0.039***	0.039***
	(0.013)	(0.013)
Constant	−17.746***	−18.052***
	(4.750)	(4.740)
R^2	0.56	0.56
N	1648	1648

Note: Standard errors in parentheses *$p < 0.1$; **$p < 0.05$; ***$p < 0.01$.
^marginal effects are significant.

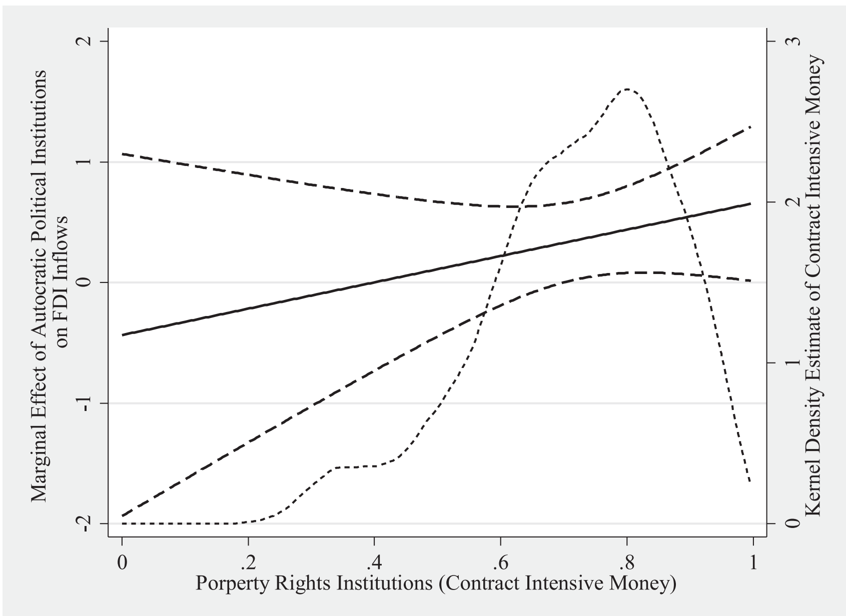

Figure 3. Marginal effects of autocratic political institutions on FDI (Model 6).

Table 4. Autocratic political institutions on FDI inflows (alternative measures).

DV: FDI inflows	Model 7	Model 8	Model 9	Model 10
Autocratic political institutions	0.714***	0.181		
	(0.220)	(0.307)		
Single party			0.945***	−2.261***
			(0.124)	(0.498)
LJI	1.935***	0.949*		
	(0.276)	(0.523)		
CIM			3.537***	2.938***
			(0.701)	(0.713)
Autocratic political institutions*LJI		2.190**		
		(0.855)		
Single party*CIM				4.853***
				(0.932)
Time horizon	−3.042	−2.993	−1.012	−0.840
	(2.035)	(2.085)	(2.061)	(2.118)
Development	0.133***	0.129***	0.106***	0.097***
	(0.025)	(0.026)	(0.023)	(0.023)
Market size	0.683***	0.684***	0.642***	0.637***
	(0.078)	(0.076)	(0.072)	(0.071)
Growth rate	0.051***	0.051***	0.057***	0.055***
	(0.008)	(0.008)	(0.008)	(0.008)
Government consumption	0.325	0.178	1.193**	0.872
	(0.585)	(0.607)	(0.594)	(0.592)
Domestic political conflict	0.005	0.003	0.026	0.018
	(0.034)	(0.034)	(0.036)	(0.035)
Sign BITs	0.736***	0.748***	0.640***	0.636***
	(0.180)	(0.177)	(0.169)	(0.163)
Oil rent	0.020***	0.020***	0.019***	0.020***
	(0.007)	(0.007)	(0.007)	(0.007)
Constant	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)
R^2	0.34	0.34	0.37	0.38
N	1770	1770	1648	1648

Note: Standard errors in parentheses $^*p < 0.1$; $^{**}p < 0.05$; $^{***}p < 0.01$.

of law. While judicial independence may not be conceptually identical to property rights, as Linzer and Staton note, the judiciary is a central institution to convince people that property rights institutions are credible.[72] LJI varies from zero to one: the higher the score, the stronger the judicial independence.

The LJI coefficient is positive and significant at the 1% level (Model 7), supporting H1. Further, the interaction between LJI and political institutions is positive (Model 8), and the political institutions' marginal effects (Figure 4) indicate the same pattern as Figures 2 and 3. Another commonly used measure of property rights institutions is the International Country Risk Guide (ICRG). The ICRG is a subjective measure of property rights and political risks, based on an expert survey. However, its main drawback is that the data coverage is limited – almost half the sample is lost in the ICRG. Nevertheless, the estimation results using the ICRG clearly support the two hypotheses. I employ a composite measure of ICRG used in Li and Resnick.[73] See Online Appendix Table A4 and Figure A3.

Lastly, Models 9 and 10 report estimation results using a different measure of political institutions. I employ a *Single Party* variable from Geddes, updated by Wright.[74] Geddes originally categorized autocratic regimes as: personalist; military; single party; and hybrids of these types. Wright updated the data to 2002 and added monarchies, including Saudi Arabia, Morocco, and Kuwait.[75] According to Geddes, single party

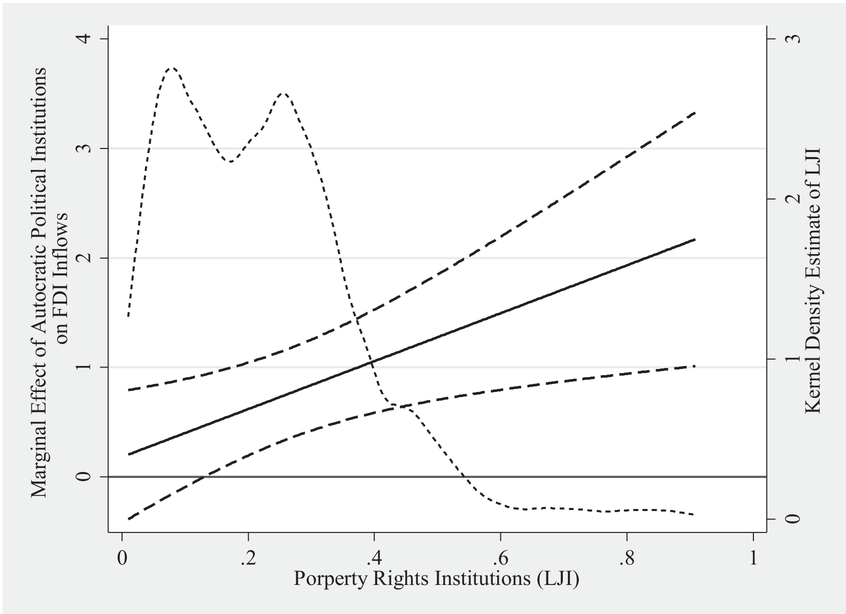

Figure 4. Marginal effects of autocratic political institutions on FDI inflows (Model 8).

regimes are where "one party dominates access to political office and control over policy, though other parties may exist and compete as minor players in elections."[76] Conceptually, single-party regimes are different from regimes with multiparty legislatures as they include both one-party and dominant-party (alongside other parties) regimes. However, as we observe in Table 5, single-party regimes tend to have legislatures much more often than any other type of autocracy. Thus, it is the closest category to the measure of political institutions used in the main estimation and worth performing a robustness test.

In Model 9, the coefficient of *Single Party* is positive and significant at the 1% level. This result is consistent with previous findings. On average, autocratic countries with a party system tend to attract more FDI than others: approximately 95%, according to Model 9. The interaction hypothesis is tested in Model 10. The direction of the interaction term is positive and significant at the 1% level. Once again, I provide a marginal effect graph (Figure 5) to observe the conditional effects of *Single Party* on FDI inflows by the level of property rights institutions. Figure 5 appears to be almost similar to the previous figures. As expected, the level of property rights institutions positively modifies the effects of *Single Party* on FDI inflows.[77]

Table 5. Autocratic institutions by regime type.

Regime type	Mean value of autocratic institutions
Single party	0.57 (458)
Military	0.31 (165)
Monarchy	0.27 (149)
Personalist	0.28 (508)
Hybrids	0.36 (368)
Total	0.38 (1648)

Note: Number of observations in parentheses.

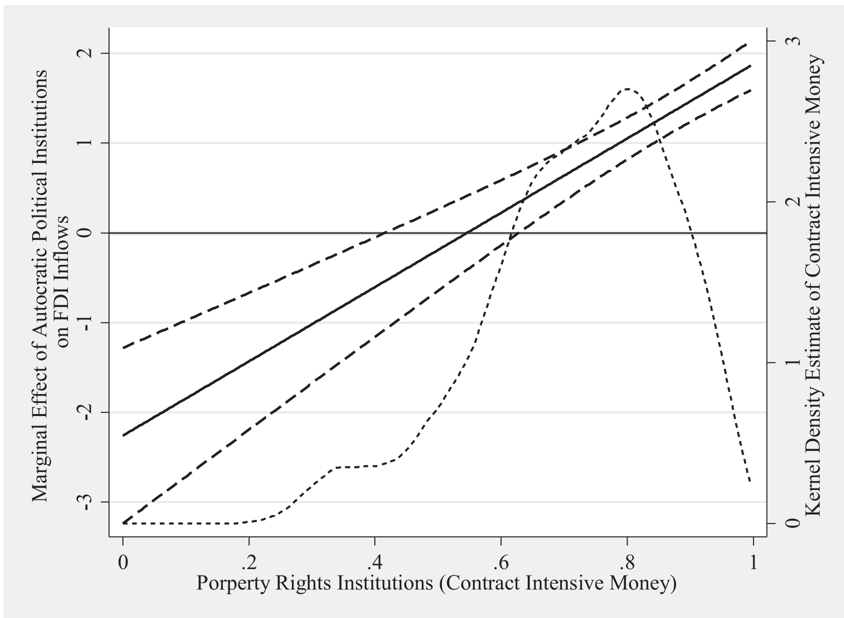

Figure 5. Marginal effects of autocratic political institutions on FDI inflows (Model 10).

Conclusion

What explains the variation in FDI inflows among autocratic countries? I focus on the role of legislatures and examine how they affect the likelihood of attracting FDI. While a growing body of literature examines the role of institutions in autocracies to explain various aspects of political and economic performance, studies on FDI performance are scant. I argue that autocratic countries with legislatures attract more FDI inflows than ones without, and the effects of the institutions are positively modified by the strength of property rights institutions. Using a panel data covering 86 authoritarian countries from 1970 to 2008, I find supporting evidence.

I acknowledge that some of the theories presented in this research may not be exclusively applied to non-democratic countries. The logic of veto players, for example, can be employed to explain the institutional environment shaping the FDI flows in democratic countries. Nevertheless, by examining the variation in FDI inflows among autocratic countries, this research contributes to both FDI and autocratic regime studies. It cuts through debate on the relationship between regime type and FDI inflows. My findings suggest that autocratic countries can take advantage of their political institutions to attract foreign capital, even if they are not fully democratized. They also confirm that institutions in autocratic regimes are not simply window-dressing,[78] but lead to different outcomes, including the investment behaviour of foreign firms.

Future scholars can further improve this research in multiple ways. First, while this research relies on national level FDI data to capture the average effects in autocratic regimes, there could be considerable variations of FDI performances between industries across countries. Using more refined FDI data at the sectoral level could enhance our understanding of the conditions attracting FDI inflows. Alternatively, similar

theoretical frameworks can be used to explain the flows of other types of capital, such as sovereign funds or portfolio investment. The researchers should also discuss how the different characteristics of each capital source (e.g. long time horizons vs. short time horizons) would be affected by the institutional framework.

Notes

1. Oatley, *International Political Economy*.
2. Brunetti, Kisunko, and Weder, *Institutional Obstacles*; Henisz, “The Institutional Environment,” 334; Jensen, “Democratic Governance”; Jun and Singh, “Foreign Direct Investment”; Schneider and Frey, “Economic and Political Determinants”; Li and Resnick, “Reversal of Fortunes.”
3. Ahlquist, “Economic Policy”; Choi and Samy, “Effect of Democratic Institutions”; Feng, “Political Freedom”; and Jensen, *Nation-States*. Li and Resnick, “Reversal of Fortunes” notably dissent.
4. Regime type is defined by Przeworski et al., *Democracy and Development.*
5. Moon, “Foreign Direct Investment”; Wright and Zhu, “Monopoly Rents.”
6. Gandhi, *Political Institutions under Dictatorship.*
7. Here, I am mainly concerned with domestic factors. For international conditions, for instance, see Büthe and Milner, “Foreign Direct Investment,” and Kerner, “What We Talk About.”
8. Henisz, “The Institutional Environment.”
9. Roberts, *Economic Policy, Political Constraints.*
10. Clague et al., “Contract-Intensive Money” and Haggard, *Pathways from the Periphery*.
11. See note 6 above. Note that Li and Resnick, “Reversal of Fortunes,” provide an alternative view that regime types have mixed effects on FDI inflows.
12. See note 8 above.
13. See note 9 above.
14. Boix and Svolik, “Limited Authoritarian Government”; Mesquita et al., *Logic of Political Survival*; Cheibub, Gandhi, and Vreeland, “Democracy and Dictatorship Revisited”; Gandhi, *Political Institutions Under Dictatorship*; Geddes, “Authoritarian Breakdown”; Gehlbach and Keefer, “Investment Without Democracy”; Gehlbach and Keefer, “Private Investment”; Levitsky and Way, *Competitive Authoritarianism*; Wright, “Do Authoritarian Institutions Constrain.” For example, Mesquita et al. adopt two institutional dimensions: the selectorate (those who choose a leader) and the winning coalition (the minimum size of support for a leader to stay in power). Cheibub et al. employ a three-way classification consisting of monarchy, military, and civilian dictator, based on the question of who can depose a leader. Geddes, *Paradigms and Sand Castles*, uses a similar classification; however, she further disaggregates “civilian dictators” into single-party and personalist dictators.
15. Gasiorowski, “Economic Crisis.”
16. Gandhi and Przeworski, “Cooperation, Cooptation, and Rebellion”; Gandhi, *Political Institutions under Dictatorship.*
17. Magaloni, “Credible Power-Sharing”; Gehlbach and Keefer, “Investment Without Democracy”; Gehlbach and Keefer, “Private Investment”; and Boix and Svolik, “Limited Authoritarian Government.”
18. Magaloni, “Credible Power-Sharing.”
19. Gehlbach and Keefer, “Investment without Democracy”; Gehlbach and Keefer, “Institutionalization of Collective Action.”
20. Boix and Svolik, “Limited Authoritarian Government.”
21. North and Weingast, “Constitutions and Commitment.”
22. Wright, “Do Authoritarian Institutions Constrain.”
23. See note 23 above.
24. North and Weingast, “Constitutions and Commitment.”
25. Gandhi, *Political Institutions under Dictatorship.*
26. Gehlbach and Keefer, “Investment Without Democracy” and Gehlbach and Keefer, “Institutionalization of Collective Action” are exceptions to this. They argue that autocracies with institutionalized ruling parties attract more private investments.
27. Bak and Moon, “Foreign Direct Investment.”
28. Rosendorff and Shin, “Importing Transparency.”

29. See note 20 above.
30. See note 24 above.
31. Tsebelis, "Decision Making."
32. Henisz, "The Institutional Environment."
33. Pinto, *Partisan Investment in the Global Economy*; Pandya, "Foreign Direct Investment Liberalization."
34. Bak and Moon, "Foreign Direct Investment," 2004.
35. Li, "Democracy, Autocracy."
36. See note 5 above.
37. See note 8 above.
38. Property rights institutions and autocratic political institutions are not severely correlated (p = 0.17).
39. Roberts, *Economic Policy, Political Constraints*.
40. See Online Appendix Table A1 and Figure A1. Some may wonder if the same logic holds with a direct measure of a veto player. One possible empirical prediction from this line of reasoning is that the number of veto players would have similar conditional effects on FDI inflows; the main findings hold when the nominally democratic institution variable is replaced with a measure of veto players (e.g. Henisz's Polcon). While it is not a main theoretical concern of this article, Online Appendix Table A1 and Figure A1 empirically confirm the validity of the logic discussed here.
41. North and Weingast, "Constitutions and Commitment."
42. Gehlbach and Keefer, "Investment Without Democracy"; Gehlbach and Keefer, "Institutionalization of Collective Action"; Wright, "Do Authoritarian Institutions Constrain."
43. Gehlbach and Keefer, "Investment Without Democracy"; Gehlbach and Keefer, "Institutionalization of Collective Action"; North and Weingast, "Constitutions and Commitment."
44. Gandhi and Przeworski, "Cooperation, Cooptation, and Rebellion."
45. Boix and Svolik, "Limited Authoritarian Government" and Magaloni, "Credible Power-Sharing."
46. Boix and Svolik, "Limited Authoritarian Government"; Gandhi and Przeworski, "Cooperation, Cooptation, and Rebellion"; Gandhi, *Political Institutions under Dictatorship*; Magaloni, "Credible Power-Sharing."
47. See note 8 above.
48. Another commonly used estimator is the panel corrected standard error model (PCSE), in Beck and Katz, "What to Do (and Not to Do)." PCSE performs poorly when the spatial dimension of the panel is large compared to the temporal dimension; Hoechle, "Robust Standard Errors," 286. Using PCSE does not change the main findings.
49. While the within-country variation is not the main concern of this research, the findings are robust with country fixed effects models See Table 2.
50. Li, "Outlier, Measurement," 174.
51. Allee and Peinhardt, "Contingent Credibility."
52. See note 50 above.
53. See Online Appendix Table A3 and Figure A2. I also perform a robustness test using FDI stocks as the dependent variable; the main findings do not change.
54. Eichengreen and Irwin, "The Role of History"; Kerner, "Why Should I"; Yeyati, Panizza, and Stein, "The Cyclical Nature."
55. Gandhi, *Political Institutions under Dictatorship*.
56. See Online Appendix Table A5. I also tested using an alternative coding scheme: 1 for the presence of legislatures (i.e. categories 1 and 2), 0 for otherwise. The results still support the hypotheses.
57. Clague et al., "Contract-Intensive Money."
58. Ahlquist and Prakash, "Foreign Direct Investment"; Rios-Figueroa and Staton, "Cross-National," 31; Souva, Smith, and Rowan, "Promoting Trade."
59. Linzer and Staton, "A Global Measure."
60. Wright, "To Invest or Insure."
61. Clague et al., "Contract-Intensive Money," 188 explain: the characteristics of third-party contract enforcement in countries are likely to explain much of the difference in firm and individual preferences governing the choice of money to use if contracts are generally unreliable. There can

be no assurance that the money lent to financial institutions is safe. Another possible control variable is expropriation events data created by Hajzler (2012), which reported three different types of expropriations acts from 1993 to 2006. While I do not include this variable due to a limited temporal domain, controlling for the variable does not change the main findings.

62. Dunning and Lundan, *Multinational Enterprises*.
63. Barro, "Democracy and Growth"; Lucas, "Mechanics of Economic Development"; Romer, "Endogenous Technical Change."
64. Brunetti, Kisunko, and Weder, *Institutional Obstacles*; Jun and Singh, "Foreign Direct Investment"; Schneider and Frey, "Economic and Political Determinants."
65. Büthe and Milner, "Bilateral Investment Treaties"; Kerner, "Why Should I."
66. World Bank Group, World Development Indicators 2011.
67. Banks and Wilson, "Cross-National Data Archive."
68. The control variables are not severely correlated with key independent variables. The correlations range from −0.13 to 0.22.
69. North and Weingast, "Constitutions and Commitment."
70. In "Understanding Interaction Models," Brambor, Clark, and Golder suggest that it is possible for the marginal effect of X on Y to be significant for substantively relevant values of the modifying variable Z, even if the coefficient on the interaction term is insignificant.
71. Linzer and Staton, "A Global Measure."
72. Ibid.
73. Li and Resnick, "Reversal of Fortunes."
74. Geddes, "Authoritarian Breakdown"; Geddes, *Paradigms and Sand Castles*; updated by Wright, "To Invest or Insure."
75. Wright, "To Invest or Insure."
76. Geddes, *Paradigms and Sand Castles*, 51.
77. Note that the online appendix tables report various additional robustness test results.
78. Gandhi, *Political Institutions under Dictatorship*.

Acknowledgements

For valuable comments, I wish to thank Dale Smith, Mark Souva, Sean Ehrlich, Christopher Reenock, Eddie Hearn, Taehee Whang, Byungwon Woo, Svitlana Chernykh, and three anonymous reviewers of *Democratization*.

Disclosure statement

No potential conflict of interest was reported by the author.

Funding

This work was supported by the National Research Foundation of Korea funded by the Korean Ministry of Education [grant number NRF-2016-S1A3A2924409].

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