

It's All Relative: How Institutions at Home Shape the Political Risks of Investing Abroad

Research questions:

- Why do some firms invest in countries with “bad” institutions?

Background:

- Existing research proposes that host countries’ political and legal institutions can attract or deter FDI. Scholars have paid particular attention to independent courts that can protect property rights and enforce contracts.
- Yet, more multinational firms are coming from home countries where institutions do not reliably protect property rights or help reduce uncertainty (see Table 1 below); these firms may react differently to “bad” institutions in potential hosts.

Table 1: Direct Investment from Developing Countries, 1970-2010

Year	Billions of USD	% of World Total
1970	0.05	0.36
1980	3.19	6.19
1990	11.91	4.93
2000	137.39	11.15
2010	388.15	29.33

Note: Data from UNCTAD 2011.

Argument:

- We argue that the effect of host country institutions on FDI depends upon the institutions that international firms have been exposed to at home.
 - Firms develop strategies and skills for dealing with non-market environment at home and prefer investment locations that do not require changing those methods.

Hypothesis:

- Firms from countries with weak judicial institutions are less deterred from investing in host countries with weak judicial institutions than firms from home countries with independent judicial institutions.

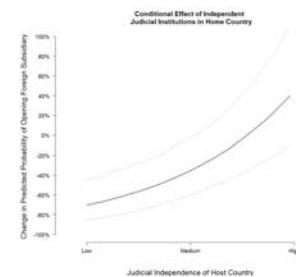
Data & Methods:

- At the micro-level, we collect data from Bureau van Dyk on the incorporation of over 10,000 foreign subsidiaries by 3870 multinational parent firms (years: 2006-2011).
- At the macro-level, we collect aggregate data from the International Monetary Fund on the FDI flowing into and originating from 163 countries (years: 2009-2011).
- We analyze the data using hierarchical logit and hierarchical linear models with random intercepts for home and host countries as well as industry.

Findings

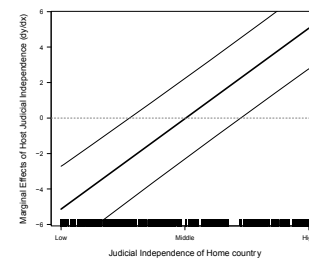
Using firm-level data:

All else equal, firms from countries with “good” institutions are more deterred by “risky” host institutions than firms coming from home countries with similarly “risky” institutions.



Using country-level data:

Countries with independent judicial institutions attract *more* FDI from other countries with independent judiciaries, but *less* from countries with weak judicial institutions.



Next step:

- Survey experiments on international business managers-in-training to study the effect of home-country experience on business actors’ perceptions of host countries’ political institutions.

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