

Democratic Institutions and Expropriation of Foreign Direct Investment

Quan Li

Associate Professor
Department of Political Science
The Pennsylvania State University
University Park, PA 16802
Phone: (814)865-6575
Fax: (814)863-8979
Email: quanli@psu.edu

Preliminary draft, comments welcome

Prepared for presentation at the Political Economy of MNE Conference at Washington University,
St. Louis, June 2005.

Democratic Institutions and Expropriation of Foreign Direct Investment

Property rights protection is one of the central concerns for foreign direct investors. Expropriation is the most extreme form of property rights violations against the multinationals. While international business scholars have explored various causes of host expropriations of foreign direct investment, they largely ignore the role of domestic political institutions, despite the fact that expropriation acts are apparently political and tied to domestic politics. In contrast, while political scientists (see, e.g., Jensen 2003; Li and Resnick 2003) studying FDI suggest that more democratic countries provide better property rights protection for foreign investors, these studies typically do not discuss why the protection of private property in democracy extends to foreign investors. More important, they fail to consider theoretically and empirically the competing forces in how democratic institutions can influence host expropriation behaviors.

In this paper, I conceptualize the conditions under which democratic institutions can reduce or increase the risks of expropriation of foreign direct investment. I start by analyzing the attributes of foreign direct investment that makes the multinationals vulnerable to host policy changes, followed by a discussion of the key attributes of democratic institutions. I then analyze how these two sets of attributes interact and covary. Theoretical expectations are derived for the conditions under which democracy reduces or promotes expropriation risks. A pooled time series cross national analysis is conducted to look at how democracy affects the likelihood of expropriations, a first test of its kind.

Literature on the Causes of FDI Expropriation

The international business literature on the causes of the expropriation of foreign direct investment is voluminous. Instead of an exhaustive review, I discuss several representative studies from the literature. Truitt (1970) examines the trends in the expropriation of American and British firms in

LDCs from 1945 to 1970. He finds that both American and British firms suffer more expropriations in the oil-extractive sector than in other sectors such as manufacturing, public utilities, and service.

Knudsen (1974) models the determinants of a country's propensity to expropriate foreign firms. He argues that the difference in the level of aspirations and the level of welfare and expectations influences the propensity of expropriations by countries from 1968 to 1971. The difference is found to affect a nation's propensity to expropriate.

Bunn and Mustafaoglu (1978) construct a model to explain the probability of sudden expropriation a firm must consider when investing in an LDC. They suggest that the opinions of experts on how the experts' individual opinions on 10 political and social determinants aggregate into a composite forecast of the risk of expropriation. These determinants include the ideology change of the host, foreigner visibility, colonial identity, demonstration, marketing skill, bureaucracy skills, level of technology, parent country relationship, reciprocal dependence, and economic performance. They apply this model to one firm's decision to invest in one country in two different periods 1978-1982 and 1983-1988.

Jodice (1980) studies why LDCs expropriated foreign-owned extractive firms. He suggested five explanations. First, there is a positive linear relationship between the modernity of the host and the number of expropriations. States of high GDP per capita have already expropriated by 1967 while the least developed countries do not have the resources to do so. Countries in the middle are most likely to expropriate. Second, states that can effectively tax and regulate are more likely to expropriate. Third, the worse the host economic performance, the more likely it will expropriate. Fourth, the more foreign aid from the US, the less likely the host will expropriate. Fifth, the more collective protest and civil war, the more likely the host will expropriate. Jodice looks at a sample of

50 states from 1968 to 1976. He finds that economic performance, state capacity, and civil war are most influential variables while collective protest and foreign aid are not statistically significant.

Kobrin (1980) studies the determinants of forced divestment and MNC expropriations. These determinants include enterprise specific factors that affect vulnerability to forced divestment, such as involvement in infrastructure activities, the sector that company is in, the level of technology, and the percent owned by parent company. Wholly foreign owned firms and those with widely diffused technology, such as the petroleum and mining sector, are most vulnerable to expropriations. He finds that manufacturing, petroleum, mining have the highest percentage of expropriations. He concludes that the host country was interested in increased control over future MNCs, rather than actively trying to nationalize all firms in its border. Forced divestment is not a reflection of national pride, an anti-foreign bias or political opportunism, but rather a policy instrument used to attempt to achieve national political economic objectives by increasing regulatory control over MNCs.

Kobrin (1984) explains the drastic decline in expropriations after 1976. He finds that 336 acts of expropriations occurred from 1970 to 1975, but only 87 acts occurred from 1976 to 1979. He argued that the decline occurred because of a number of reasons. First, expropriations in the extractive sector were almost complete by 1976. Second, the increased duration of independence of the LDCs and increased government capabilities removed some of the incentives to expropriate. Third, the poor economic conditions in the balance of payments and debt in many LDCs pushed many LDCs to pursue foreign capital and reduced their incentive to expropriate.

Minor (1994) extends the analysis in Kobrin (1984) to years from 1980 to 1992. He finds there were only 16 acts of expropriations in this period. The evidence is consistent with the explanations Kobrin (1984) suggested. In addition, he noted that the declining trend in expropriations acts has been accompanied by a rise in the number of privatizations in the LDCs.

Thomas and Worrall (1994) examine formally the conditions under which a contract between the host and an MNC is self-enforcing and does not encourage short term gains from renegeing when international law can not enforce a contract. They suggest that for any given risk neutral country (one not more likely to expropriate than others), the conflict between short term (expropriation) incentives and long term (non-nationalization) incentives determines the type of investment contracts agreed. The only feasible contracts are self-enforcing if the long term benefits from adhering to the contract exceed the short term gains.

These studies have largely ignored the role of domestic political institutions. While the temporal trend in the decline of expropriation acts is accompanied by the emergence and diffusion of new democracies, scholars have largely ignored both the theoretical and empirical connections between these two phenomena.

How Does Democracy Influence Expropriation of FDI?

Attributes of International Production

A multinational enterprise organizes production of goods and services in more than one country, involving the transfer of assets or intermediate products within the investing enterprise and without any change in ownership. Foreign direct investment (FDI) is the purchase of physical assets or a significant amount of the ownership (stock) of a company in another country to gain a measure of management control. About 3/4 of IMF nations use the 10% rule to define foreign direct investment in data collection, that is, 10% or more of the ordinary shares or voting power or the equivalent establishes a direct investment relationship.

Scholarship in international business (see, e.g., Dunning 1988, 1993) suggests that national firms become transnational in order to exploit three types of advantages: (1) a firm's advantages due to ownership over tangible and intangible assets, (2) the firm's internalization advantages from its

hierarchical control of cross-border production, and (3) the location-specific advantages perceived by firms or the characteristics of host countries in terms of their economic environment or government policies.

Attributes of international production imply that foreign direct investment is characterized by cross border jurisdiction, ex post illiquid nature of FDI and long time horizon of foreign investors. Both issues cause foreign capital to be in a precarious position in the host countries. First, cross border jurisdiction implies that foreign investors may be treated differently than domestic investors. Because foreign direct investment is foreign in the host country, subject to laws and regulation in the host country, inter-jurisdictional issues arise and foreign investors may not be equally protected as domestic firms. Second, foreign direct investment is illiquid ex post because of the long term nature of the investment. It is vulnerable to the obsolescence of bargaining power vis-à-vis host governments. Ex post illiquid nature of FDI and long time horizon of foreign investors imply that they expect to exist for a long time in the host economy but that their bargaining power vis-à-vis the host government tends to obsolesce over time. These two attributes of foreign direct investment make foreign investors particularly concerned about the safety of their assets and private rights in the host developing country.

These characteristics of international production render the monitoring and enforcing their property rights in the host state a central concern for foreign investors (see, e.g., Kobrin 1984; Frieden 1994). Where host governments perceive greater benefits from taking over the foreign assets and operating on their own are greater than the costs, they would do so. Otherwise, they will leave foreign firms intact. Foreign investors fear the grabbing hand of the host government that is rent seeking, extractive and lacks credibility. I argue that the nature of domestic political institutions can amplify or reduce the expropriation risks foreign investments are exposed to.

Effects of Democratic Institutions on Expropriation Risk

The mechanisms through which democracy influences the expropriation risks faced by foreign investors depend on the key attributes of democratic institutions. Following Dahl (1971; 1998), I define representation democracy as implying free and fair elections of the executive and legislative offices, the right of citizens to vote and compete for public office, and institutional guarantees for the freedom of association and expression such as an independent judiciary and the absence of censorship. Relative to an autocracy, the democratic host government faces “regular constitutional opportunities for changing the governing officials, and a social mechanism that permits the largest possible part of the population to influence major contenders for political office” (Lipset 1960, 27). These key attributes of democratic institutions may generate competing effects on the expropriation risks faced by foreign investors.

Government Constraints and Negative Effect of Democracy

The host state monopolizes the coercive power to define and enforce property rights within its own territory. The prerogative makes the ex ante promise of protection of their assets questionable for the foreign investors. MNCs are necessarily concerned about the ex post compliance by the host government. In the absence of other legitimate authority within the country, the host state does not need to follow through on its promise to respect or protect foreign assets. In addition, because the host-MNC contract is not complete, the state can renege on the agreement ex post under various contingencies (e.g., war). As North and Weingast (1989) noted, concern for reputation and the shadow of the future are not sufficient to guarantee state compliance with its agreements with the private agent. These issues, discussed in length in Olson (1993; 2000) and North and Weingast (1989) with respect to the state-market relationship, also apply to the host-MNC interactions. The question is what aspects of democratic institutions will restrain the state from grabbing private

foreign assets, restoring its credibility and commitment in the eyes of the foreign investor.

Fundamentally, the provision of protection relies on a constrained state. How does democracy and autocracy differ in that regard?

As noted, representative democracy allows various interests to compete for office and be represented in the legislature, leading to checks and balances and the diversity of interests in the legislature. Public policymaking in democracy involves the dispersion of power, the limited executive, the large number of veto players over public policy, and the independent judiciary. Government constraints prevent individual interests to be snatched by the leviathan. As a result, it is argued that more democratic governments offer better protection of private property rights (Olson 1993 and 2000; Bates 2001; and North and Weingast 1989). For example, because the British Parliament gained greater control vis-à-vis the Crown over fiscal policy (borrowing and taxation), legislative and judicial power, private business interests became more secure (North and Weingast 1989). “Increasing the number of veto players implied that a larger set of constituencies could protect themselves against political assault, thus markedly reducing the circumstances under which opportunistic behavior by the government could take place” (North and Weingast 1989). In addition, because the diversity of interests in the legislature and a politically independent judiciary raised the cost of supplying private benefits, the Parliament did not elapse into another rent-seeking Crown. From the earliest agrarian society to the current post Cold War era, because the state delegates power to entrepreneurs and businessmen to form economic organizations and oversee the use of force, the individuals become willing to invest (Bates 2001). It is the limits on the government that give credibility to the property rights institutions.

In contrast, autocratic rule involves a smaller winning coalition, and autocratic politics biases in favor of narrow elite control over public policy. The credibility of the autocratic leader is weakened because he is accountable merely to the ruling elite and exercise power out of his own

volition. Even though stable autocracies with a long time horizon, like the stationary bandit, also may offer secure property rights, they will face succession problems sooner or later (Olson 1993; McGuire and Olson 1996). In addition, the stable autocracies refrain from excessive rent seeking in order to maximize their own wealth holding over the long run, the effect of which is not likely to be as strong and stable as institutionalized government constraints in established stable democracies (McGuire and Olson 1996). For lasting democracies, secure property rights are temporally stable because they are compatible with the intrinsic democratic institutions, such as checks and balances, limited executive, and the independent judiciary, that are necessary for the survival of democracy (McGuire and Olson 1996; Olson 2000). Empirically, more democratic countries are found to have better property rights institutions than less democratic ones, including stable autocracies (see, e.g., Clague et al 1996; Li and Resnick 2003).

While government constraints lead to credible commitment to private property rights in democracies, will that protection be extended to foreign investors? The answer is affirmative for several reasons. First, the entry and presence of multinational firms benefit certain individuals and groups in the host (see, e.g., Lipsey 2002). MNCs bring into the host capital, advanced technology, and managerial skills. They also may increase employment in the host country and mobilize local savings. MNCs also are argued to produce positive spillovers in terms of productivity, wage, and export in the host countries, especially those abundant in labor. These benefits create a constituency of support for the multinationals. Second, the inclusion of a wide range of interests in the democratic political process is likely to encompass those that benefit from FDI. Beneficiaries of foreign entry in a society of wide representation, regardless the size of that group, are likely to be represented politically in the winning coalition. The larger number of veto players in democracies lower the level of political hazard foreign investors confront in the host country (Henisz, 2000). While interests supporting the multinationals may be better represented sometimes in an autocratic

regime, the preference of the ruling elite in the autocracy does not always favor the multinationals, generating greater policy volatility for the foreign investors. Third, in order to win re-election, politicians in democracies have incentives to develop public policies that promote economic growth. To the extent that FDI is believed to enhance the host economy and national governments compete for foreign capital, the host leaders have a private incentive not to expropriate foreign firms. Therefore, one may expect that democratic institutions in general and government constraints in particular reduce the expropriation risks for foreign investors.

Redistribution Bias and Positive Effect of Democracy

The same attributes of democracy that reduce the expropriation risks for foreign investors may increase the appeal of expropriation as a political strategy for politicians in democracies under certain conditions. The analytical premise of this expectation is the so-called redistribution bias in democracy, an idea studied in depth in the literature on taxation and growth (see, e.g., Alesina and Rodrik 1994; Persson and Tabellini 1994a, 1994b). The idea is that because the median voter in democracy tends to be from the poorer section of a population, he has an incentive to use his political power to promote a higher tax rate and obtain redistribution in favor of the poor. The question is under what conditions politicians in democracy are likely to express such redistribution bias in the form of expropriating the assets of the multinationals.

Such opportunities are likely to arise when politicians have a short time horizon and/or when they expropriate the foreign assets to favor their core constituency. These opportunities further become politically because democratic politics ensure regular government turnovers and policy swings. I argue that such redistribution bias against foreign investors is likely to become appealing in the following two situations: (1) when a new democratic government comes into power, and (2) when a democratic government of leftist ideology comes into power.

New democracies often disrupt existing private property rights for political purposes. They violate pre-existing property rights to secure popular support and solidify power. Przeworski (1991, 34) brings up the land reform in poor developing countries as a good example. As new democratic governments attempt to provide subsistence or earning opportunities for the rural population, investors end up losing their land. In such regimes, politicians may not take a long run view but adopt policies that maximize their short term political gains. Hence, the initial establishment of democracy, particularly the conduct of an election itself, does not necessarily lead to secure property rights (Olson 2000, 41). Clague et al (1996) show empirically that new democracies tend to be weak in protecting private property rights. New democratic regimes often are associated with economic nationalism and face strong populist anti-FDI sentiment. As a result, expropriating the assets of the multinationals can be a politically attractive strategy for new democratic regimes.

Hawkin, Mintz and Provisiero (1976) suggest that communist or socialist governments are ideologically opposed to large private enterprises and hence, tend to nationalize all large foreign firms. They find that most expropriations are committed by such governments. A similar partisan bias may also exist in democratic regimes. The left government has its core constituency in labor and often tends toward an interventionist policy toward capital owners, such as imposing capital controls (see, e.g., Alesina, Grilli and Milesi-Ferretti 1994; Grilli and Milesi-Ferretti 1995; Quinn and Inclan 1997). In contrast, the right government is more oriented toward laissez faire policies and appeal to multinational corporations, capital owners and the financial community. The bias of redistribution through expropriation appears more obvious in the left government. Hence, all else equal, the left government is more likely to expropriate foreign assets than the right government.

Data, Measures and Methods

I evaluate the expectations of the competing effects of democracy in a pooled time series cross sectional analysis. The dependent measure is the expropriation risk variable constructed by a private consulting firm “PRS Group” (Political Risk Service Group). The variable, ranging from 0 to 10, refers to the risk of “outright confiscation or forced nationalization” (Knack and Keefer 1995, 226). The scale is inverted so that higher values indicate higher risks for foreign investors. The PRS group is a risk-rating agency that specializes in information gathering and analysis, selling its research as a product to potential foreign investors. It is a direct measure of the perceived risk of expropriation for foreign investors. To the extent that institutions are “rules, enforcement characteristics of rules, and norms of behavior that structure repeated human interaction” (North 1989), the measure also reflects the strength of property rights protection for foreign investors in terms of enforcement characteristics of rules. Data on this measure cover 130 countries from 1982 to 1997.

As an aggregate level measure of democratic institutions, I use the POLITY2 variable from the POLITY IV database (Marshall and Jaggers 2000). The widely used POLITY data register various democratic and autocratic attributes for many countries on an annual basis from 1800, with POLITY IV updating to 1999. The POLITY dataset operationalizes institutionalized democracy and autocracy along five dimensions: Competitiveness of political participation, regulation of political participation, competitiveness of executive recruitment, openness of executive recruitment, and constraints on the chief executive. The POLITY2 variable is constructed as the difference between DEMOC and AUTOC, ranging from -10 (strongly autocratic) to +10 (strongly democratic). The same measure is used in various previous studies (e.g., Jensen 2003; Li and Resnich 2003). The coefficient for the variable measures the net effect of democracy.

To assess the particular effect of government constraints, I employ the executive constraints variable from the POLITY IV database. It measures the extent of institutionalized constraints on the decision making power of chief executives, reflecting the checks and balances in the policy

making process. It is on a seven-point scale, with one indicating unlimited authority and seven denoting executive parity or subordination. The variable should have a negative effect.

To capture the positive effect of democracy on expropriation risks, I construct two variables, new democracy and left government. New democracy is a dummy variable coded 1 for the first three years of a democratic regime and 0 otherwise. A country is defined as a democracy if the widely used composite indicator of regime type from POLITY IV is greater than or equal to 6 (see, e.g., Dixon 1994). The variable should have a positive effect.

Left government is a dummy variable coded 1 if a country is a democracy following the above coding rule and has a left government in power and 0 otherwise. The government partisanship data are from Beck et al. (2001). The variable should have a positive effect on expropriation risk. Similarly, right government and center government variables also are constructed for democracies for additional tests.

A number of control variables are included in estimation to ensure that the findings on the effect of democracy are not spurious. Clague et al (1996) find that the longer the autocratic leader in power, the more the leader behaves like a stationary bandit by taking a long run view, the more he will offer better private property rights protection to maximize his tax revenues. The logic appears applicable to the expropriation of the multinationals as well. Following them, the variable autocrat duration measures the number of consecutive years that the chief executive in an autocratic country has been in power. A country is defined as an autocracy if the POLITY2 variable has a value equal to or smaller than 0, following the POLITY IV database manual. Data on the number of years the chief executive has been in power are from Beck et al. (2001). The variable should have a negative effect on expropriation risks.

Lipson (1985) suggests that the principal challenge to foreign investment security is the lapse of host internal order. In such situations, either governments prey on foreign assets for short term

gains or fail to enforce the rule of law. To capture the effect, I employ the state failure variable from the POLITY IV database. It is coded 1 for years when a polity is considered to be in a condition of “complete collapse of central authority” or “state failure”, when a state disintegrates, or when a profound revolutionary change in political authority occurs, and 0 otherwise. The variable should have a positive effect on expropriation risks.

The wealth and income level of the host country also may affect the expropriation risks faced by foreign investors (see, e.g., Jodice 1980). I control for the initial wealth differences between countries by using the logged real GDP per capita, PPP from the Penn World Table dataset. Higher wealth levels correlate with stronger governance capacity and greater citizen satisfaction, reducing the expropriation risk for foreign investors.

To the extent that the dependent variable reflects the quality of the property rights institution for foreign investors, it bears the inertia property of institutions. Such inertia, if not controlled for, often leads to spurious findings. In addition to this theoretical reason, this lagged variable also helps to capture the effects of variables not present in the model. To the extent that the inclusion of the lagged dependent variable makes it harder for us to find statistically significant results, the modeling approach can be described as conservative.

As Kobrin (1984) and Minor (1994) find, the expropriation behaviors of host governments exhibit several temporal characteristics. First, there has been a linear trend in the declining of expropriation acts by host governments. Hence there should be a corresponding linear trend in the level of risk perceived by foreign investors. I use a year counter variable to capture this pattern. Second, particular years mark peaks or troughs in expropriation activities. This suggests that paradigmatic events may occur in certain years, but not others. I control for such year specific years by including the year dummies.

The estimation sample covers about 94 countries for 14 years. The data has a pooled time series cross sectional (TSCS) structure, allowing us to identify patterns across countries and over time. Despite such inferential advantages, the TSCS design involves potentially more serious assumption violations than the non-panel design in terms of heteroskedasticity, autocorrelation and contemporaneous correlation in the error term (Stimson 1985). To deal with these problems, Beck and Katz (1995) recommend ordinary least square (OLS) with panel corrected standard errors (PCSEs). The PCSEs adjust for disturbances that are heteroskedastic and contemporaneously correlated across panels. I also correct for possible AR(1) serial correlation in the error term. Since the main hypotheses are directional, I apply the one-tailed test. As many of the independent variables may be affected by the dependent variable, I control for the possible reciprocal effect by lagging the relevant key independent variables by one year.

Findings

Statistical results are presented in Table 1 for all countries and in Table 2 for the non-OECD countries. Each table includes four model specifications. Model 1 is the full model, Model 2 excludes the right democratic government variable, Model 3 excludes from Model 1 the lagged dependent variable, and Model 4 replaces the Polity2 variable in Model 1 with the executive constraint variable. These results provide robustness tests under different model specifications. Results from all countries remain consistent, if not stronger, for the developing countries. Hence I focus on discussing the results for the all country sample.

In Table 1, Polity2 measuring the quality of democratic institutions has a statistically significant negative effect, as expected. More democratic countries are associated with lower expropriation risks for foreign investors. But the size of the effect appears moderate. Based on the estimate of Model 1, a one-standard deviation in-sample increase (7.28) in the level of democracy is

associated with only 0.12 decrease in the expropriation risk scale, a 1.5% drop along the in-sample maximum-minimum range of the scale. Even in Model 3 excluding the lagged dependent variable, the effect still is small, a 4.4% decrease.

Consistent with the result of Polity2, Model 4 shows that the executive constraints variable has a statistically significant negative effect on the expropriation risk. Again, the effect appears small in size. A one-standard deviation in-sample increase (2.26) in the government constraints is associated with only 0.7 decrease in the expropriation risk scale, a 0.88% drop along the in-sample maximum-minimum range of the scale.

The effect of new democracy is positive and statistically significant in Table 1, as expected. New democratic regimes in their first three years are associated with high levels of expropriation risks. Based on the estimate of Model 1, compared with other democratic regimes, a new democracy has a risk score higher by 0.1, which is equivalent as a 1.2% rise along the in-sample maximum-minimum range of the scale. But once we exclude the lagged dependent variable in Model 3, a new democracy is associated with a 2.8% increase in the scale. The size of the effect can be substantial.

The results for the left democratic government are not as expected, but reveal interesting implications. Model 1 shows that relative to non-democratic regimes, the left government may be associated with less expropriation risks, but the effect is not significant statistically. The equality test between the effects of the left and right governments is nearly significant, but with the left government associated with lower risks than the right government. The pattern holds in Model 2 and Model 4, but not in Model 3 where the left government is not statistically different from the right government. The results are plausible in the context of the sample period. During the sample period, countries competed for foreign direct investment, including many left democratic governments. The fact that these governments have the same or even lower level of expropriation

risks is because their reputation led them to suffer a credibility deficit in the eyes of foreign investors. As a result, to compensate for their weakness, they have to make conscious efforts to build and strengthen their property rights protection institutions for foreign investors.

The tenure of the autocratic leader has a statistically significant negative effect on the expropriation risk, as expected. Autocrats that are stable in power have an incentive to create an investment climate friendly to foreign investors. By restraining themselves from preying on the assets of the multinationals, they expect to maximize the economic pie for themselves over time. The effect is consistent across all four models in Table 1.

Conclusion

Focusing on expropriation risks, I analyze how democratic institutions influence the host property rights protection for foreign direct investors. Based on the conventional wisdom that more democratic countries are associated with better property rights protection, political scientists of FDI often assume that the mechanism applies to foreign investors equally well. Meanwhile, the role of democratic institutions on expropriation has never been rigorously explored in the international business literature. Does the same pattern for domestic firms hold for foreign investors? Are there other mechanisms at work that mitigate the commonly believed benign effect of democracy? What do the empirics tell us?

Addressing these questions, I offer several arguments for how democratic institutions influence the host expropriation of foreign direct investment. I argue that the essential attributes of democracy may generate competing effects under various conditions. I test these expectations in a sample that covers 96 countries for 14 years. The findings are illuminating. First, democratic institutions in general and government constraints in particular do reduce the expropriation risk for foreign investors. But the substantive effect is small in size. Second, new democracies tend to be

more aggressive in expropriating foreign assets than other democracies. The size of this effect is substantively important. Third, the left partisan bias in democracy disappeared for the sample period. In fact, the left government may be more protective of foreign assets in order to compensate their credibility deficit in seeking to attract foreign capital. Finally, the tenure of the autocratic leader is found to be negatively associated with the expropriation risk.

References

- Alesina, Alberto, Vittorio Grilli and Gian Maria Milesi-Ferretti. 1994. "The Political Economy of Capital Controls." In *Capital Mobility: The Impact on Consumption, Investment and Growth*, ed. Leonardo Leiderman and Assaf Razin. Cambridge: Cambridge Press. Pp. 2890-321.
- Bates, Robert H. 2001. *Prosperity and Violence*. New York: Norton.
- Beck, Nathaniel, and Jonathan Katz. 1995. What to Do (and Not to Do) with Times-Series Cross-Section Data in Comparative Politics. *American Political Science Review* 89 (3):634-48.
- Beck, Thorsten, George Clarke, Alberto Groff, Philip Keefer, and Patrick Walsh. 2001. "New tools in comparative political economy: The Database of Political Institutions." *World Bank Economic Review* 15(September): 165-76.
- Clague, Christopher, Philip Keefer, Stephen Knack and Mancur Olson. 1996. Property and Contract Rights in Autocracies and Democracies. *Journal of Economic Growth* 1 (2):243-76.
- Dahl, Robert A. 1971. *Polyarchy: Participation and Opposition*. New Haven: Yale University Press.
- Dahl, Robert A. 1998. *On Democracy*. New Haven: Yale University Press.
- Dunning, John. 1988. *Explaining International Production*. London: Unwin Hyman.
- Dunning, John. 1993. *Multinational Enterprises and the Global Economy*. New York: Addison-Wesley.
- Dixon, William J. 1994. "Democracy and the Peaceful Settlement of International Conflict." *American Political Science Review* 88: 14-32.
- Dixon, William J. and Terry Boswell. 1996. Dependency, Disarticulation, and Denominator Effects: Another Look at Foreign Capital Penetration. *American Journal of Sociology* 102 (2):543-62.
- Frieden, Jeffrey A. 1994. International Investment and Colonial Control: A New Interpretation. *International Organization* 48 (4):559-593.

- Grilli, Vittorio and Gian Maria Milesi-Ferretti. 1995. "Economic Effects and Structural Determinants of Capital Controls." *IMF Staff Papers* 42 (3): 517-551.
- Henisz, W. J. 2000. The Institutional Environment for Multinational Investment. *Journal of Law, Economics and Organization*, 16(2): 334-64.
- Jensen, Nathan. 2003. "Democratic Governance and Multinational Corporations: The Political Economy of Foreign Direct Investment." *International Organization* 57(3): 587-616.
- Jodice, D. 1980. "Sources of Change in Third World Regimes for Foreign Direct Investment--1968-1976." *International Organization* 34(2): 177-206.
- Knack, Stephen and Philip Keefer. 1995. Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures. *Economics and Politics* 7 (3):207-27.
- Kobrin, Stephen J.. "Foreign Enterprise and Forced Divestment in LDCs." *International Organization* 34 (Winter 1980): 65–88.**
- Kobrin, Stephen J. 1984. Expropriation as an Attempt to Control Foreign Firms in LDCs: Trends from 1960 to 1979. *International Studies Quarterly* 28 (3):329-48.
- Li, Quan and Adam Resnick. 2003. "Reversal of Fortunes: Democracy, Property Rights and Foreign Direct Investment Inflows in Developing Countries." *International Organization* 57(1): 175-214.
- Linz, Juan. 2000. *Totalitarian and Authoritarian Regimes*. Boulder, CO: Lynne Rienner.
- Lipson, Charles. 1985. *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* Berkeley and Los Angeles: University of California Press.
- Marshall, Monty G. and Keith Jagers. 2000. *Polity IV Project: Political Regime Characteristics and Transitions, 1800-1999*. <http://www.bsos.umd.edu/cidcm>.
- Minor, Michael. 1994. "The Demise of Expropriation as an Instrument of LDC Policy" *Journal of International Business Studies* 177-188.
- North, Douglass C. 1990. *Institutions, Institutional Change and Economic Performance*. Cambridge, UK: Cambridge University Press.
- North, Douglass C. and Barry R. Weingast. 1989. Constitutions and Commitment: The Evolution of Institutional Governing Public Choice in Seventeenth-Century England. *Journal of Economic History* 49 (4):803-832.
- Olson, Mancur. 1993. *Dictatorship, Democracy, and Development*. *American Political Science Review* 87 (3):567-76.
- Olson, Mancur. 2000. *Power and Prosperity*. New York: Basic Books.

- Persson, T., Tabellini, G., 1994a. Is inequality harmful for growth? Theory and evidence. *American Economic Review* 84, 600-621.
- Persson, T., Tabellini, G., 1994b. *Monetary and Fiscal Policy*. vol. II. Politics. MIT Press, Cambridge, MA.
- Przeworski, Adam. 1991. *Democracy and the Market*. New York: Cambridge University Press.
- Quinn, Dennis P. and Carla Inclan. 1997. "The Origins of Financial Openness: A Study of Current and Capital Account Liberalization." *American Journal of Political Science*, 41 (3): 771-813.
- Stimson, James. 1985. Regression in Space and Time: A Statistical Essay. *American Journal of Political Science* 29 (4):914-47.

Table 1 Effect of Democratic Institutions on Expropriation of FDI (All Countries, 1982-1996)

	<i>Model 1</i>	<i>Model 2</i>	<i>Model 2</i>	<i>Model 2</i>
Polity2	-0.017*** (0.006)	-0.018*** (0.004)	-0.050*** (0.011)	
Government constraints				-0.032* (0.018)
New democracy	0.099* (0.074)	0.096* (0.074)	0.232** (0.096)	0.098* (0.077)
Left government	-0.094* (0.074)	-0.070* (0.043)	-0.121 (0.115)	-0.152** (0.068)
Right government	-0.032 (0.064)		-0.149* (0.093)	-0.091* (0.060)
Autocrat duration	-0.008** (0.003)	-0.008** (0.003)	-0.014** (0.005)	-0.006* (0.004)
State failure	0.238 (0.254)	0.243 (0.253)	0.406 (0.341)	0.639* (0.476)
Initial wealth level	-0.082* (0.054)	-0.083* (0.054)	-0.860*** (0.189)	-0.077* (0.054)
Past expropriation	0.827*** (0.037)	0.828*** (0.038)		0.827*** (0.036)
Trend	0.0005* (0.0002)	0.0005* (0.0002)	0.004*** (0.001)	0.0005** (0.0002)
Observations	1223	1223	1258	1194
R-squared	0.94	0.94	0.74	0.94

Year dummies not reported

PCSE Standard errors in parentheses

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

Table 2 Effect of Democratic Institutions on Expropriation of FDI (Non-OECD, 1982-1996)

	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>
Polity2	-0.014*** (0.005)	-0.016*** (0.004)	-0.040*** (0.011)	
Government constraints				-0.029** (0.017)
New democracy	0.119* (0.072)	0.116* (0.072)	0.215** (0.096)	0.115* (0.077)
Left government	-0.114* (0.075)	-0.088* (0.055)	-0.150 (0.135)	-0.155** (0.069)
Right government	-0.038 (0.064)		-0.186* (0.099)	-0.088* (0.061)
Autocrat duration	-0.007** (0.003)	-0.007** (0.003)	-0.014*** (0.005)	-0.006* (0.004)
State failure	0.279 (0.244)	0.287 (0.243)	0.582** (0.348)	0.651* (0.466)
Initial wealth level	-0.095* (0.060)	-0.095* (0.060)	-0.599*** (0.225)	-0.081* (0.061)
Past expropriation	0.820*** (0.039)	0.821*** (0.039)		0.820*** (0.037)
Trend	0.0005* (0.0003)	0.0005* (0.0003)	0.003*** (0.001)	0.0005* (0.0003)
Observations	1000	1000	1020	971
R-squared	0.93	0.93	0.76	0.94

Year dummies not reported

Standard errors in parentheses

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