Nexus between Political Regime and FDI Revisited: A Cross-Country Evidence

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Abstract

This research investigates the relation between political regime and foreign direct investment (FDI) at cross-country level. It has been long debated issue whether democratic or autocratic system of government attracts FDI in host country. The current study gathers new evidence using the cross-country data of 28 countries for the period of 1995-2016 to explore the effect of political regime on FDI. The data of regime type has been taken from Freedom House and represents top fourteen (14) democratic countries and top fourteen (14) autocratic countries. Inward FDI figures have been downloaded from World Bank Indicators. The comparative assessment of top ten recipients of FDI, with respect to political regime type, includes both democratic and autocratic countries over the years. Thus, it provides the mixed evidence that political regime does not play a significant role in the long-run for attracting more FDI. However, the greater inflows of FDI in host country depend upon the effective long-term and persistent investors' friendly policies. The investors and policy makers should understand the role of economic, social, cultural and other policy variables while devising appropriate strategies rather than relying upon mere classification of political regime type.

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Key Words

Autocracy, Democracy, Freedom Score, FDI

1. Introduction

Political system of a country plays an important role in attracting foreign direct investment in a country (Li, 2009). Therefore, foreign investors and multinational companies (MNCs) are often interested in the type of political regime in the host country. It has been a very hot debate over last few decades about which type of political system is more beneficial for influencing FDI inflows in a country. The answer is not as straightforward as it seems to be because proponents of democracy claim so high about the potential benefits of democratic system. MNCs often create lobbying and pressure groups in the host country to influence the policies in their favour and run their operations smoothly in the host country (Duanmu, 2014). The empirical evidence on effect of politcal regime on FDI is mixed because this relation is moderated by other policy variables such as tax rate, wage rate differentials, inflation and interest rate, financial and tax incentives to foreign and local investors, tariffs, development of local infrastructure, exchange rate policy, economic development, quality of burecracy and instiutions, rule of law and natural resources (Asiedu & Lien, 2010; Bastiaens, 2016; Busse &Hefeker, 2007; Clauge, 1996; Daude & Stein, 2007; Jensen, 2003; Li, 2006).

Each type of political regime such as democracy or autocracy has its own merits and demerits. Democratic system is often attached with lower political risk due to protection of intellectual rights and contracts (Jensen, 2003). Madani & Nobakht (2014) documented the positive effect of democratic system on FDI of upper middle-income countries (UMCs). However, in developing countries, democratic governments have not achieved the desired results in encouraging foreign investors because of the phenomenon of ‘immature democracies’ (Li, 2009). Since these governments have problem of long lasting democracies and political leaders may lead to expropriate foreign investors. In some cases, authoritarian governments could be better than immature democracies if the leaders of such political system have long-term planning horizons such as China; they could provide better outcomes to MNCs in liberalization policies and flexible trade and fiscal policies (Donnell, Donnell, & Paulo, 2014). On the other hand, Li and Resnick (2003) argued that corrupt autocracies are benefical for MNCs because they provide monoplistic power to these firms over local firms.

The purpose of current study is to investigate the effect of political regime on FDI at cross-country level. The paper has used the novel measure of freedom score developed by Freedom House to compare both autocratic and democratic countries based on FDI inflows. The USA and China comparison of FDI has also been made which represents the cases of largest democratic and autocratic systems respectively in the world. The paper has contributed to the existing literature by making an extensive literature review to come up with the latest findings. Firstly, it provides latest global trends of FDI and MNCs operations. Secondly, it investigates the relation between political regime and FDI at cross-country level. The policy makers should realize the importance of political system and related policy variables while making investment, trade, fiscal and monetary policies.

2. Global Trends of FDI and MNCs' Operations

Before analysing the effect of political regime, it is very important to know about the international trends of FDI and rising operations of MNCs over the globe. Now MNCs could be considered as separate empires and their financial budget is even bigger than several developing countries. Therefore, understanding the nature and power of MNCs is essential before making any policy for foreign investors. This section makes discussion about top ten countries receiving the most FDI in the world and top ten countries with the most multinational companies.

Table 1) Top Ten Countries Receiving FDI (Rounded off to the nearest Billion dollars)

S. No.	Country	FDI Inflows-2016	Country	FDI Inflows-2017
1	USA	479	USA	311
2	UK	300	China	144

3	China	171	Hong Kong	85
4	Nether-lands	81	Nether-lands	68
5	Ireland	79	Ireland	66
6	Brazil	79	Australia	60
7	Singapore	62	Brazil	60
8	Germany	53	Singapore	58
9	India	44	France	50
10	France	42	India	45

Source: World Bank and UNCTAD Global Investment Trends Monitor.

Table 1 depicts top ten countries who received the most FDI during 2016-17. USA is at the top receiving the highest FDI inflows, 479 billion dollars and 311billion dollars for 2016 and 2017 respectively. In 2016, UK was the second largest country in terms of FDI, receiving 300 billion dollars of foreign direct investment inflows. However, China improved its position from being third in 2016 to second in 2017 and getting FDI inflows of 144 billion dollars.

The other European countries that have been attractive for foreign direct investment include Netherlands, Ireland, Germany and France. However, India is the largest recipient of FDI inflows in South Asia. Most countries in this list are democratic countries except China where single-party system exists. But China has been able to attract more foreign investment due to liberalization and investors friendly policies.

Table 2) Top 10 countries with the most Global 500 companies

Rank	**Country**	**No. of Companies**
1	United States	126
2	China	120
3	Japan	52

4	Germany	32
5	France	28
6	United Kingdom	21
7	South Korea	16
8	Netherlands	15
9	Switzerland	14
10	Canada	12

Source: Fortune Global 500

Table 2 depicts top ten countries with the most 500 global companies. USA has 126 largest MNCs in the world. USA is the largest democracy and promoting its values through MNCs. China is the second on the list due to its opening up of domestic market for foreign investments. Chinese multinational companies have achieved tremendous growth. The other countries include Japan, Germany, France, UK, Netherlands, South Korea, Switzerland and Canada. All these countries belong to democratic set up except China which is socialistic country.

3. Literature Review

It is quite evident that political factors affect the investment decisions of multinational companies about location of their operations in host country. The basic question which the existing literature addresses is whether MNCs have preference for democratic or autocratic countries for investments. However, there is mixed evidence on this research question. Democracies are preferred because they offer many incentives such as intellectual property rights protection (Clague, 1996; Jensen, 2003). Jensen (2003) postulated that democratic countries may lower the country risk by providing better financial and other incentives and, therefore, attract more FDI. He evidenced that democratic regimes attracted 70% more FDI as a percentage of GDP than that of autocratic countries. Harms & Ursprung (2002) argued that countries which provide civil and political freedom attract more FDI into their countries. Yang (2007) made analysis of 134 developing countries but did not find any systematic relationship between democratic regime and FDI. Foreign investors associate democratic countries with better intellectual and other property rights protection, yet several MNCs have been found to invest in autocratic countries (Bastiaens, 2016). Several empirical studies found positive effect of democracy on FDI (Asiedu & Lien, 2010; Awad & Ragab, 2018). Nieman & Thies (2018) tested the effect of democratic institutions in promoting property rights and its influence upon FDI. They evidenced the positive effect of democratic institutions on FDI and this effect has substantially increased because of technological innovation in both developed and developing countries.

One problem with democratic system, especially in developing countries, is generally non-existence of long-lasting democracies; it may encourage democratic leaders to expropriate foreign investors and MNCs at the benefit of their personal gains (Clague, 1996; Li, 2009). Li (2009) empirically tested the impact of political regime on expropriation of MNCs. He evidenced that both democracies and autocracies may lead to expropriation behaviour by host government. However, the chances of such expropriating behaviour are lower in democratic government, but it depends upon certain political variables such as political constraints and leadership turnover. When there is higher turnover of political leadership and lesser political constraints upon leaders, the probability of expropriation behaviour goes higher. On the other hand, autocracies have very low probability to expropriate when leaders have long-term planning horizons and higher political constraints (Clague, 1996; Duanmu, 2014). Democratic systems may adversely affect the monopolistic power of MNCs and may hinder the fiscal, financial, infrastructure and legal incentives offered by host governments (Jensen, 2003; Li & Resnick, 2003). Duanmu (2014) stated that state-owned MNCs such as Chinese firms may address such issues by utilizing the diplomatic influence known as gunboat or soft power diplomacy; however, the effectiveness of such political influence depends upon the level of economic growth and mutual relationship between home and host governments.

Autocratic governments are normally considered bad for attracting FDI because of political uncertainty, abusive regime, lack of property rights and contracts protections, rule of law and governance issues. But autocracies may have their own advantage over democracies if autocrats are visionary and have long-term planning horizons; in that case secured property rights, favourable tax rates and wage rates could be offered to MNCs (Clague, 1996; Donnell, Donnell, & Paulo, 2014). Donnell et al. (2014) pointed out that the stable and long-term autocracies like China have incentives to provide property rights to attract FDI; more foreign investment means higher collection of tax revenues and economic growth.

Oneal (1994) discussed the benefits of authoritarian regimes in terms of benefits to MNCs but found inconsistent results; MNCs achieved higher returns mainly in democracies but the rate of return in case of only periphery sector was greater in authoritarian regime. Li & Resnick (2003) also viewed autocracies beneficial for those MNCs which offer bribes to government officials to maintain their monopolistic position in the host country. Therefore, MCNs who support corruption, such political environment could be favourable for their dominance over the local investors and businessmen who may not challenge the policies of authoritarian regime. Jakobsen & de Soysa (2006) challenged the viewpoint of Li & Resnick (2003) by pointing out the artefacts and biases associated with sampling and econometric modelling. Using a large sample of LDCs, they have found positive effect of democracy on FDI.

Corruption is normally perceived to have negative effect on FDI due to expropriating behaviour of government officials in host countries. Egger & Winner (2005) challenged this notion that corruption has negative effect on FDI. In their empirical analysis of 73 developed and developing countries, they found that corrupt regimes attract more FDI in their countries. On the other hand, Cuervo-Cazurra (2006) found the contradictory results and found that corruption has negative effect on FDI for those countries which have signed international agreement on corruption control, namely, Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. This

Anti-Bribery Convention has been developed by OECFD countries to curb bribery and corruption. It means all MNCs do not support corruption especially when they belong to those countries that have established laws and tight control over corruption. Therefore, the matter of corruption should also be considered while checking the effect of political regime. Moreover, Vadlamannati, Janz, & Berntsen (2018) examined the effect of human rights violations in a large sample of 165 countries and found that abusive and outcast regimes have lower level of FDI inflows due to human rights violations and public condemnations under UN.

Ledyaeva, Karhunen, & Kosonen (2013) investigated the effect of cross-cultural and political commonalities between foreign investors and host countries. He found out that foreign investors from corrupt and less democratic countries make more investment in Russian regions. Dang (2015) also suggested that political, cultural and economic similarities between host and home countries is a major factor in attracting FDI.

Geyikdagi (1983) tested the effect of political risk upon MNCs during Islamic revolution in Iran and its possible spill over effect upon Saudi Arabia, Kuwait and UAE. These countries are autocratic Islamic countries and the operations of MNCs were expected to be affected by the wave of Iranian resolution. However, such spill over did not have any significant effect on FDI because of secured nature of investment and sales contract. The MNCs were paid advance payments upon such contracts resulting in substantial decrease in political risk. Li (2006) emphasized that institutional quality substantially reduces political risk and attracts FDI. Higher political risk is associated with autocracies because of government expropriation of foreign investors, undue interventions in MNCs operations, violations of contracts and ineffective policies, absence of rule of law, lack of good governance, undue regulations, lack of government commitment and uncertain policies (Bastiaens, 2016; Daude & Stein, 2007; Vadlamannati et al., 2018).

The contradictory and mixed evidence of effect of political regime upon FDI has led the researcher to consider other related and moderating factors. For example, public deliberations and their consideration into investment policy formulation and international investments treaties between foreign investors and host country can really moderate the relation between political regime and FDI. Asiedu & Lien (2010) examined the role of natural resources in affecting the relationship between political regime and FDI. They concluded that FDI has a positive significant effect on FDI only if the value of natural resources falls below than a certain critical threshold. Bastiaens (2016) empirically tested the effect of public deliberations on FDI in autocratic or authoritarian regimes. He argued that autocratic leaders in authoritarian regimes had attracted substantial FDI by formulating and implementing friendly investment policies because public input is considered vital and their masses are provided opportunities through public deliberation activities in terms of seminars, workshops and events.

Luo (2004) argued that host government whether autocratic or democratic should provide consistent policies and political stability. Therefore, the cooperation between MNCs and host countries could be beneficial for both the parties. It does not mean the element of local competition for MNCs could be eliminated by host countries because conflict for local resources and market access is natural even the host government has adopted liberalized investment policies for MNCs. Therefore, MNCs should consider level of economic development, industrial growth, regulatory environment and political stability along with political regime before making any investment in host country. Luo, Xue, & Han (2010) emphasized to explore the linkage between political system and business enterprises because some countries such as China influence outward FDI by dissuading local private firms.

The relationship between political system and FDI has a complex nature and it depends upon several dimensions of political system. There are several other studies which have empirically tested the effect of political system using multi-dimensional analysis upon MNCs. Busse & Hefeker (2007) also examined the effect of political risk and institutions upon FDI. He identified such determinants of FDI such as corruption and ethnicity, rule of law, external and internal conflict, accountability of government, political stability and quality of bureaucracy. Therefore, the effect of political system is contingent upon these factors whether a country adopts an autocratic or democratic system. In another study on

OECD countries, Wisniewski & Pathan (2014) investigated the several dimensions of political system on FDI. They found that MNCs invest in those countries which have lower level of government expenditures, prolonged power of ruling party for several periods, existence of presidential system, ruling party has control over policy making, and established political parties. Duanmu & Urdinez (2018) found new evidence that some countries such as China influence their state-owned companies (SOEs) as soft balancing and economic diplomacy to reduce investments in host countries which are under the influence of USA companies. These SOEs are provided all the support by the government in terms of financial and strategic resources, market access and monopolistic position in the home country.

4. Methodology

The paper evaluates the relation between political regime and FDI. The data about political regime has been taken from Freedom in the World Report 2018 published by Freedom House established by Bush Administration as a Democracy Project. Political Regime is ranked variable and represents level of democracy in a country measured on the aggregate score from 0 to 100 developed by Freedom House. This aggregate score represents ordinal rating for civil liberties and political rights and ranges from 1 indicating the freest country to 7 representing less free. There are 25 indicators with four (4) points each representing these two dimensions of civil and political rights. Based on these two dimensions representing 25 indicators, countries have been declared completely free, partly free and not free at all.

Data on FDI inflows has been taken from World Bank Indicators Database for a period ranging from 1995-2016. The year 2017 has been dropped because of missing values for several countries in our sample for a comparative purpose. FDI inflows have been divided into three periods, namely, 1995-2001, 2002-2008 and post crises period 2009-2016; yearly averages and overall average of the entire sample have been calculated to gauge any significant shift in FDI trends in different regimes. Two measures have been taken to represent FDI inflows; FDI as percent of GDP and FDI as current BOP figure to evaluate the effect of political regime on FDI. FDI as percent of GDP is a better measure when the size of country is used as scaling to compare small and big economies. The results have been reported in tabular and graphical form and descriptive analysis have been represented to provide the reader with more intuitive and quicker look at the major differences between democratic and autocratic countries.

North Korea has been dropped out of our sample because of non-availability of FDI data from World Bank. Initially, 20 democratic countries and the same number of autocratic countries were taken for comparative purpose. However, the consistent FDI data was available for only 28 countries from 1995-2016 from World Bank Indicators (WDI) database. The data of Freedom House is more reliable because it represents the real-world rights and liberties enjoyed by individuals.

The comparison of USA representing largest democracy and China representing largest autocracy has also been separately carried out for policy purpose and derive the major differences between the approaches of two countries. The results have been reported in the form of table and graphs.

5. Results and Discussion

The results have been classified into two main streams. Firstly, cross-country evidence has been provided based upon ranking of countries in terms of democratic and political rights of masses and respective FDI figures to determine whether type of political regime matters for attracting FDI in their home countries. Secondly, comparison of USA and China, which are representatives of largest democracies and autocracies respectively, has been made.

5.1 Cross Country Evidence- Political Regime and FDI

The trends of FDI in Table 3 represent mixed evidence about effect of political regime on FDI as percent of GDP. We have listed twenty-eight (28) countries in the table; these countries have been divided into two groups representing the highest and lowest quintile with reference to freedom rights. The countries having the highest freedom score (FS) represent famous democracies and lowest freedom score (FS) represents autocracies in the world. Democratic governments have FS score ranging from 90 to 100 and autocratic governments have score from 0 to 13 as measured by Freedom House agency. The scoring done by Freedom house is considered more appropriate because it also considers the protection of individual rights and liberty.

For the sake of brevity and clarity, 28 countries have been listed and average FDI trends have been divided into four periods, 1995-2001, 2002-2008, 2009-2016 and then overall average of FDI. These periods have been separated to gauge any structural change in the countries. The third column represents regime type which is dichotomous variable representing 1 for democratic government and 0 for autocratic governments. The column four represents freedom score as given by Freedom House. The fifth column represents FDI as percent of GDP. All the countries in three periods have been listed in descending order in terms of highest FDI percentage.

In the first period (1995-2001), Azerbaijan (an autocracy) is at the top representing an average of 15.67 percent of FDI. Bahrain, which is also an autocratic government, takes the second place in the ranking and has 8.68% of FDI inflows into its country during the said period. Among the top ten countries, democratic governments such as Sweden, Netherlands and Denmark take the subsequent third, fourth and fifth places.

Table 3) Political Regime and FDI as Percent of GDP

No	Country	FS	1995 - 2001	Country	2002 - 2008	Country	2009 - 2016	Country	Avg.
1	Azer-baijan	12	15.67	Netherlands	31.63	Nether-lands	23.21	Nether-lands	20.88
2	Bahrain	12	8.68	Azerbaijan	31.31	Turk-menistan	12.83	Azer-baijan	7.89
3	Sweden	100	8.24	Iceland	12.83	Azer-baijan	7.03	Turk-menistan	18.00
4	Nether-lands	99	7.80	Bahrain	7.27	Switzer-land	5.78	Bahrain	4.72
5	Denmark	97	6.44	Tajik-istan	7.05	Guinea	5.06	Iceland	2.86
6	Turk-menistan	4	5.02	Cuba	6.46	Portugal	4.55	Sweden	3.44

7	Cuba	14	4.95	UK	6.23	Australi a	3.43	Cuba	2.95
8	UK	95	4.19	Sweden	5.90	Bahrain	3.30	Switzerlan d	6.42
9	Finland	100	4.14	Turk-menistan	5.83	Iceland	3.26	UK	5.80
10	China	14	4.13	Sudan	5.26	Cuba	3.07	Tajik-istan	4.83
11	Canada	99	3.60	Finland	5.09	Suadi Arabia	2.85	Finland	2.02
12	Switzer-land	96	3.52	Switzer-Land	4.85	China	2.80	China	3.63
13	Norway	100	2.80	China	3.97	UK	2.77	Portugal	4.40
14	Uruguay	98	2.78	Canada	3.43	Uruguay	2.72	Sudan	2.94
15	Portugal	97	2.60	Uruguay	3.33	Canada	2.70	Canada	3.24
16	Australia	98	2.19	Australia	3.23	Tajikis-tan	2.63	Australia	3.75
17	Sudan	8	2.18	Norway	3.22	Ethiopia	2.49	Uruguay	2.51
18	New Zealand	98	2.01	Portugal	3.16	Sudan	2.39	Guinea	3.28
19	Ethiopia	12	1.99	Saudi Arabia	3.04	Finland	1.85	Denmark	3.69
20	Tajik-istan	11	1.57	Ethiopia	3.04	Uzbek-istan	1.70	Norway	1.30
21	Iceland	97	1.32	Guinea	2.97	CAR	1.55	Ethiopia	1.42
22	Uzbe-kistan	7	0.64	Libya	2.85	Norway	1.51	Saudi Arabia	2.51
23	Equatoria l Guinea	7	0.54	Yemen	2.20	Libya	1.44	New Zealand	1.34
24	CAR	9	0.54	CAR	2.16	Sweden	0.79	CAR	4.98
25	Saudi Arabia	7	0.18	New Zealand	1.72	New Zealand	0.72	Libya	1.49
26	Japan	96	0.11	Uzbe-kistan	1.55	Denmar k	0.24	Uzbek-istan	2.68
27	Libya	9	-0.26	Denmark	1.36	Japan	0.24	Japan	0.19
28	Yemen	13	-2.00	Japan	0.24	Yemen	-0.56	Yemen	- 0.12

Source: Authors' calculation based upon data of World Bank Indicators and Freedom House (FH).

Note: No. means serial number; Avg. means average; CAR means Central African Republican

Both democratic and autocratic governments are included among top ten countries receiving FDI inflows. It implies mixed evidence and may indicate that the long-term investment policies and political stability also matters rather than being autocratic or democratic government. In other periods and overall average of FDI in last column, the same findings can be derived, and one could argue safely that the question of political regime and its effect of FDI is not a straight forward answer and requires for considering other policy factors along with political system.

Table 4 depicts the same ranking of countries with reference to FDI in billions of dollars measured at current balance of payment (BOP) figure. Again, we have rather mixed evidence in all the specified period. Among top ten countries receiving most FDI inflows, both democratic governments (such as UK, Canada, Sweden, Norway) and autocratic governments (such as China, Saudi Arabia, Azerbaijan, Tajikistan) are listed. The China has attracted huge FDI inflows from period 2009-2016 due to its liberalization policy, trade openness and investment friendly policies. Therefore, mixed evidence implies that long-term economic policies and government stability, investment and trade policies, taxation and incentives to foreign investors are also considered along with political regime type.

Table 4) Political Regime and FDI (Billion Dollars at current BOP)

No	Country	FS	1995-2001	Country	2002-2008	Country	2009-2016	Country	Avg.
1	UK	95	67.3	UK	1617.3	China	103.63	Japan	586.21
2	China	14	26.5	Canada	447.6	UK	74.08	Finland	172.77
3	Canada	99	25.0	China	375.0	Australia	45.87	Norway	168.39
4	Sweden	100	21.8	Sweden	245.2	Canada	45.72	Sudan	95.14
5	Denmark	97	10.9	Australia	230.9	Switzer-land	37.31	Australia	90.26
6	Switzer-land	96	10.1	Switzer-land	204.6	Saudi Arabia	15.83	Azer-baijan	83.99
7	Australia	98	8.7	Saudi Arabia	132.4	Japan	11.79	Iceland	49.49

8	Finland	10 0	5.4	Norway	113.5	Portugal	10.22	Tajik-istan	42.33
9	Japan	96	4.9	Finland	111.0	Norway	7.40	Turkm-enistan	41.82
10	Norway	10 0	4.6	Japan	110.3	Finland	4.50	Portugal	40.30
11	Portugal	97	3.1	Portugal	64.1	Azerbaija n	3.95	Uruguay	25.84
12	New Zealand	98	1.3	Azer-baijan	40.4	Turkmen-istan	3.92	Switzer-land	16.33
13	Azer-baijan	12	0.7	Denmark	37.2	Sweden	3.79	China	15.01
14	Bahrain	12	0.6	Iceland	23.2	Uruguay	2.40	Bahrain	7.92
15	Guinea	7	0.3	New Zealand	19.4	Sudan	1.70	New Zealand	7.34
16	Sudan	8	0.3	Libya	17.9	Ethiopia	1.40	CAR	6.30
17	Saudi Arabia	7	0.2	Sudan	14.5	New Zealand	1.32	Ethiopia	5.48
18	Uruguay	98	0.2	Bahrain	13.0	Guinea	1.05	UK	4.87
19	Nether-lands	99	0.2	Uruguay	9.7	Libya	1.04	Sweden	4.09
20	Ethiopia	12	0.2	Turkmen -istan	5.9	Bahrain	1.04	Saudi Arabia	3.32
21	Turk-menista n	4	0.1	Yemen	4.9	Denmark	0.86	Nether-lands	1.90
22	Iceland	97	0.1	Guinea	4.3	Nether-lands	0.77	Guinea	1.67
23	Uzbek-istan	7	0.1	Ethiopia	3.4	Uzbek-istan	0.76	Yemen	1.56
24	Tajik-istan	11	0.0	Nether-lands	3.1	Iceland	0.47	Canada	1.37
25	CAR	9	0.0	Uzbek-istan	3.0	Tajik-istan	0.20	Denmar k	1.29
26	Libya	9	-0.1	Tajik-istan	2.1	CAR	0.03	Libya	0.77
27	Yemen	13	-0.1	CAR	0.4	Yemen	-0.14	Uzbek-istan	0.13

Source: Authors' calculation based upon data of World Bank Indicators and Freedom House (FH).

Note: No. means serial number; Avg. means average; CAR means Central African Republican

5.2 FDI Comparison between USA and China

We have also made comparison in terms of FDI as percentage FDI and actual FDI in billion dollars between two largest economies of the world, USA and China. Both USA and China are largest representatives of democratic and autocratic regimes respectively. The data of FDI has been taken from 1982 to 2017 from World Bank Indicators of World Bank. The average values have also been worked out for the entire period to summarize the results.

Table 5) Comparison of USA and China in Terms of FDI

Year	China-FDI	USA-FDI	AFDI-China	AFDI-USA
2000	3.48	3.40	42.1	164.1
2001	3.51	1.61	47.1	56.1
2002	3.61	1.00	53.1	89.8
2003	3.49	0.97	57.9	36.0
2004	3.48	1.69	68.1	87.1
2005	4.55	1.06	104.1	252.7
2006	4.51	2.12	124.1	203.6
2007	4.40	2.35	156.2	209.5
2008	3.73	2.26	171.5	253.5
2009	2.56	1.07	131.1	14.5
2010	3.99	1.73	243.7	66.7
2011	3.70	1.66	280.1	27.0
2012	2.82	1.55	241.2	46.8
2013	3.03	1.73	290.9	54.5
2014	2.56	1.36	268.1	58.9

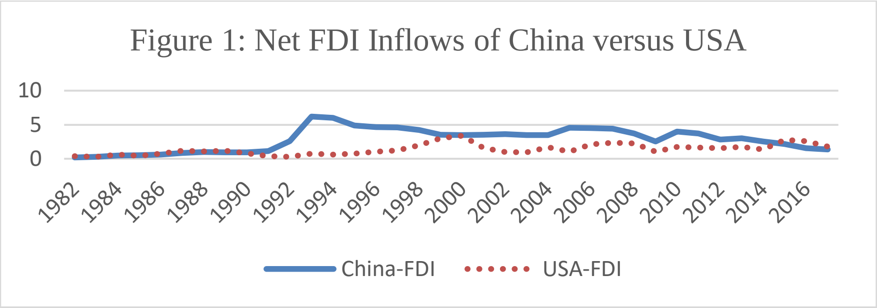
2015	2.19	2.79	242.5	58.5
2016	1.56	2.57	174.7	265.8
2017	1.37	1.80	168.2	46.6
Average (2000-2017)	*3.25*	*1.82*	*159.15*	*110.64*
Average (1982-2017)	*2.84*	*1.38*	*87.85*	*67.51*

Source: Authors' calculation from WDI

Note: FDI is percent of GDP and AFDI represents actual figure of FDI in billions of US dollars

If we look at the overall trend of FDI in column 2 and 3 of Table 5, it is quite evident that FDI inflows grows rapidly over the years as compared to those of USA, though in some years USA outperformed China in FDI inflows. However, the average FDI inflows as percent of GDP amount to 2.84% for China approximately as compared to 1.38 percent for USA. The column 4 and 5 represents FDI in billion dollars for China and USA respectively. On the average, China has outperformed USA in terms of FDI; it amounts to approximately 87.8 billion dollars for China and 67.5 billion dollars for USA respectively. It implies that both percentage and absolute FDI figures support the liberalization policy of China that brought tremendous amount of FDI in China.

Figure 1 displays the graphical comparison of net FDI inflows between China versus USA based upon Table 5. As evidenced by line graph, there has been tremendous growth in FDI inflows for China after liberalization of economy in 1978. Deng Xiaoping implemented economic reforms in China in the year 1978 when he took charge of authoritarian regime. The China moved from centrally controlled economy to market economy and it resulted in substantial foreign investment and growth in China. The market opening resulted in huge inflows of FDI and export development and China built up huge foreign reserves and achieved substantial economic growth. After implementation of reforms in 1978 by then government, we observe steep growth in FDI inflows of China over the next decade. China has comparatively higher trend of FDI inflows (as depicted by blue line) as compared to those of USA.



The cross-country evidence provides somewhat mixed evidence; both democracies and autocracies are listed in top-ten democratic ranking of countries with respect to FDI. Our results confirm to previous studies that both autocratic and democratic countries can attract FDI if they have investors' friendly policies and long-term planning horizons coupled with good governance and institutional quality (Clauge, 1996; Donnell et al., 2014; Duanmu, 2014; Jensen, 2003). Our comparison of USA and China also reveals the same results that China being world's largest autocracy has been able to attract higher FDI, as compared to USA, after implementation of liberalization policies in 1978. It brought tremendous volume of FDI inflows into China and the country achieved the rapid economic growth.

6. Conclusion and Policy Implications

For measuring level of democracy, a novel index called freedom score developed by Freedom House has been used for ranking of countries based upon economic and political freedom with special focus on protection of individual persons in the home country receiving FDI inflows. The top ten countries receiving FDI inflows include both autocratic and democratic countries. Therefore, there is mixed evidence that both types of political regime may encourage FDI inflows depending upon their investment policies. A separate comparison between USA and China representing the largest democracy and autocracy respectively in the world has been made to identify the trends and patterns of FDI over a period 1982-2017. China has attracted more FDI as compared to USA after its liberalization reforms in 1978 and it achieved tremendous economic growth. The average FDI inflows of China have been greater than USA. Therefore, there exists a misconception in the world that autocracies discourage FDI due to political uncertainty and lack of economic freedom and unfriendly investment policies. However, the cross-country evidence and case of China explicitly states that autocracies with long-term planning horizons and effective investment policies could be even better than immature democracies failing to complete tenure and implement consistent investment policies.

The current study has implications for policy makers, foreign investors and academicians to use the findings of this research to make appropriate policies. The policy makers should realize the stability and maturity of democratic system and take steps to improve governance practices in the long run because the investors tend to be more concerned with consistency of policies and investors friendly policies rather than sudden shifts in democratic process. Multinational companies normally support indirectly those political leaders, through pressure groups and lobbying, that ensure the longevity and consistency of investors-oriented policies to attract more FDI in the country. Therefore, foreign investors prefer that type of political system whether democratic or authoritarian that fulfils their desired needs.

7. Direction for Future Research

The academicians should realize the complex consequences of political system upon FDI as the effect of type of political regime is not a straight-forward answer and is moderated and influenced by other related factors and policies such as exchange rate policy, trade policy, public investment policy, financial development strategies; these factors have long-term association with FDI and should be considered along with political regime. The researcher can take other policy variables along with political regime type to draw more valid conclusion.

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