

# Political Risk is Relative: How Home Institutions Shape Investment Abroad

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# Political Institutions & FDI

## A Quick Recap

Domestic political institutions → political risk → investment outcomes

Institutions reduce political risk by:

- constraining opportunistic behavior
- making property rights more secure
- reducing policy uncertainty

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**Our claim:** Whether institutions attract or deter FDI depends on investors' institutional environment at home.

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**Home institutions affect how firms act to protect their business interests.**

**These practices influence where firms are better prepared to operate abroad.**

- Depending on host institutions, these pre-existing practices can be an advantage or disadvantage.

# Empirical Predictions

Applied to judicial independence (JI)

**High JI home → more likely to invest in host with high JI**

**Low JI home → more likely to invest in host with low JI**

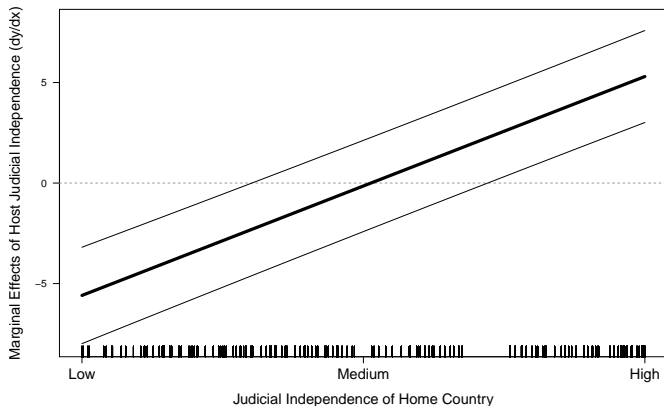


# Firm-level Data: Creation of Firms' Foreign Subsidiaries (2007-2011)

DV: NEW FOREIGN SUBSIDIARY <i>dummy; 1 = subsidiary established</i>		
	(1)	(2)
JUDICIAL INDEPENDENCE <i>LJI latent scale, ranging 0 to 1</i>		
HOME × HOST	<b>1.917***</b> (0.307)	<b>2.157***</b> (0.404)
HOME	-1.369*** (0.273)	-1.801*** (0.357)
HOST	3.362*** (0.463)	1.768* (1.040)
<i>Number of Observations</i>	398,508	345,709
<i>Number of Host Countries</i>	103	99
<i>Number of Home Countries</i>	62	56
<i>All Control Variables</i>	No	Yes
<i>Sector Intercepts</i>	No	Yes

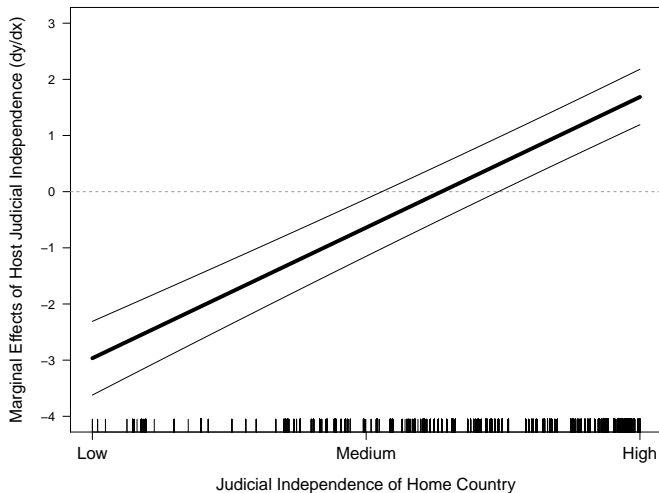
# IMF Data: Bilateral Outward FDI Positions (2009-2011)

Marginal Effects of Host Institutions, Conditional on Home Institutions



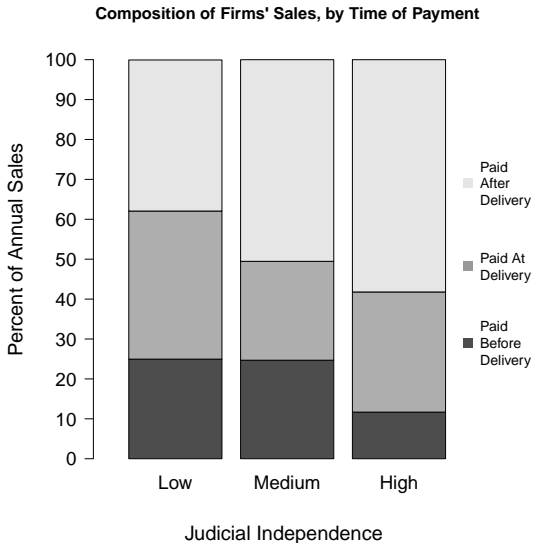
# UNCTAD Data: Bilateral FDI Flows (1981-2006)

Marginal Effects of Host Institutions, Conditional on Home Institutions



# Firm Survey Data: Testing the Mechanism

Do firm strategies vary systematically across institutional environments?



## Conclusion: Political Risk is Relative

- “Good” institutions are not uniformly attractive to FDI.
- Not all investing firms come from the OECD.
- Variation in investing firms’ background influences attractiveness of host environment.
- Countries with “bad” institutions still attract FDI because some investors already have the tools for dealing with unreliable institutions.

Thank you in advance for comments and suggestions.

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# Is Political Risk Relative?

A theoretical question motivated by an empirical trend

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

Year	<i>Billions of USD</i>	<i>% of World Total</i>
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

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