Prospectus Defense

The political determinants of FDI spillover and corruption

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Table of Contents

"One dollar from FDI is worth no more or less than one dollar of domestic investment" – Dani Rodrik

Motivation

- FDI is important for growth because of its technological spillover

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- 10% increase in foreign presence = 9% increase in local suppliers' productivity (Havranek and Irsova, 2011)

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- High spillover: Taiwan (60s, 70s), Singapore (70s, 80s) electronics
- Low spillover: Mexico, Costa Rica, Malaysia electronics

Motivation

- Economic explanation: low absorptive capacity, weak financial institutions

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- But all of these are affected by policy, so where is the government?

Motivation: The government's role

- Many works on institutions and *quantity* of FDI (Jensen, 2003; Li and Resnick, 2003; Ahlquist, 2006)

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- Many works on institutions and *quantity* of FDI (Jensen, 2003; Li and Resnick, 2003; Ahlquist, 2006)
- Few works on politics and *quality* of FDI

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If a policy area is not politicized, politicians' private benefits come into play

- A different approach from a sectoral (Pandya, 2008) or a partisan (Pinto, 2013) explanation

Motivation

Thus, FDI spillover and corruption

Table of Contents

Model: choices

One actor: the government official

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Choice over a two-good bundle: spillover and
private benefits

Model: the constraint

There is a trade off between *spillover* and *private benefits* because offering either good cuts into the firm's profit

... and the firm wants to maintain a minimum level of profit

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Model: the constraint

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- Spillover: local content requirement
- Private benefit: upfront cost and uncertainty cost

... and the firm wants to maintain a minimum level of profit

Model: parameters of the constraint
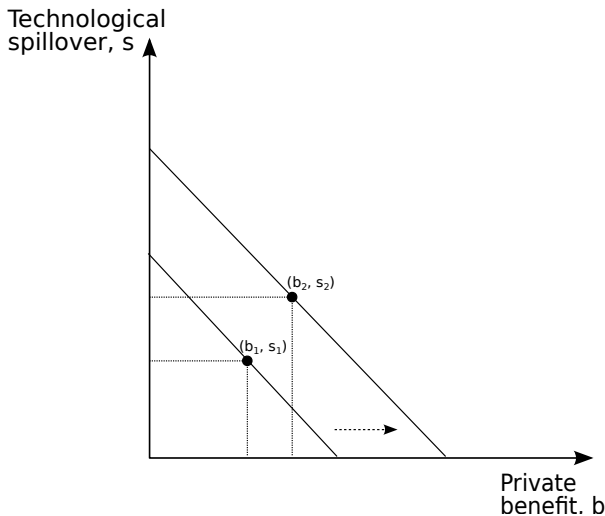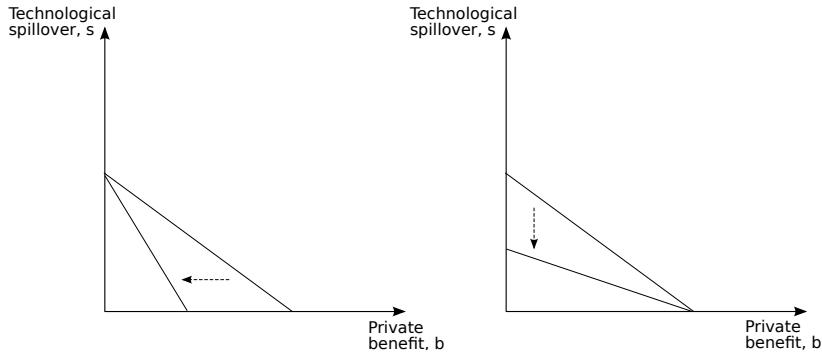
Model: parameters of the constraint
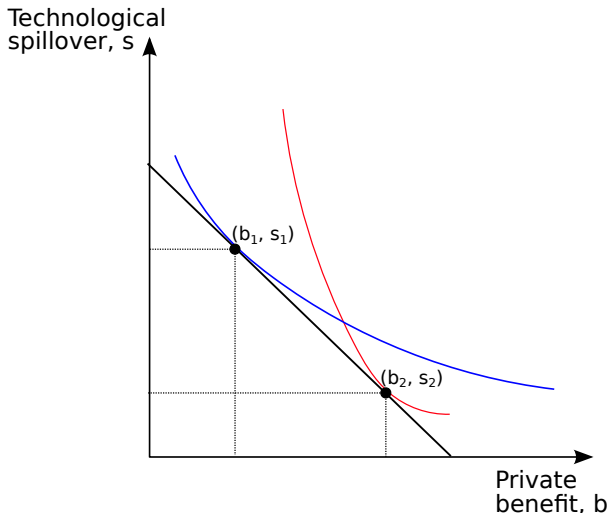
''Price'' of spillover

Model: parameters of the constraint

''Price'' of spillover
"Price" of private benefits

Model: parameters of the constraint

Model: the official's utility function

Technological spillover, s

Private benefit, b

(b_1, s_1)

(b_2, s_2)

Model: What are the assumptions?

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1. The firm only cares about its bottom line
2. The firm is profit satisficing (not profit maximizing). This will be relaxed using the two-sided logit matching model

Table of Contents

Project 1—"price" of spillover

- Officials extract spillover from firms with high potential for spillover and get bribes from the others

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- Officials extract spillover from firms with high potential for spillover and get bribes from the others
- Empirical strategy: Instrument for *spillover potential*
  - Spillover in US industries as the instrument. The weak instrument issue is there but that can be tested
  - Question: Data from any other country that can be used to estimate spillover?

Project 2—"price" of private benefits

- ► Officials extract bribes from firms for whom it costs less to bribe

Project 2—"price" of private benefits

- Officials extract bribes from firms for whom it costs less to bribe
- Empirical strategy: OECD anti-bribery convention as an exogenous shock to the price of bribes (diff-in-diff)

Project 3—the official's utility function

- Officials with a short time horizon prefer private benefits over bribe

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- Officials with a short time horizon prefer private benefits over bribe
- Empirical strategy: term-limit for Vietnamese provincial official (RDD)

Project 4—two-sided logit matching

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- Empirical strategy: two-sided logit

Project 4—two-sided logit matching

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Project 4—two-sided logit matching

- A many (firms)-to-one (country) matching problem
- Goal: Estimate the preference of firms and officials regarding one another's traits
- Data: a random sample of firms and where they invest
- Expectation Maximization algorithm to fill in the unobserved investment offer
- Question: BEA requires citizenship. Any other data?

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