Prospectus Defense

The political determinants of FDI spillover and corruption

Anh Le

November 17, 2015

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

Motivation

- FDI is important for growth because of its technological spillover
- 10% increase in foreign presence = 9% increase in local suppliers' productivity (Havranek and Irsova, 2011)

Motivation

- But the effect is highly heterogeneous

Motivation

- But the effect is highly heterogeneous
- High spillover: Taiwan (60s, 70s), Singapore (70s, 80s) electronics

Motivation

- But the effect is highly heterogeneous
- 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

Motivation

- Economic explanation: low absorptive capacity, weak financial institutions
- 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)

Motivation: The government's role

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

Motivation: The government's role

Voters / citizens probably do not care

- ▸ Low salience of trade policies even in highly affected groups (Guisinger, 2009)

Motivation: The government's role

Voters / citizens probably do not care

- ▸ Low salience of trade policies even in highly affected groups (Guisinger, 2009)

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

Motivation: The government's role

Voters / citizens probably do not care

- Low salience of trade policies even in highly affected groups (Guisinger, 2009)

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

Model: choices

One actor: the government official
Choice over two-good bundle: spillover and private benefit

Model: the constraint

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

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

Model: the constraint

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

- ▶ Spillover: local content requirement

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

Model: the constraint

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

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

... and the firm wants to maintain a minimum level of profit
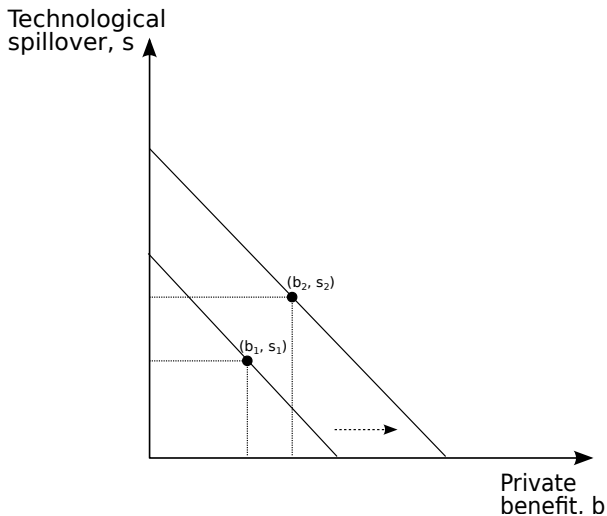
Model: parameters of the constraint

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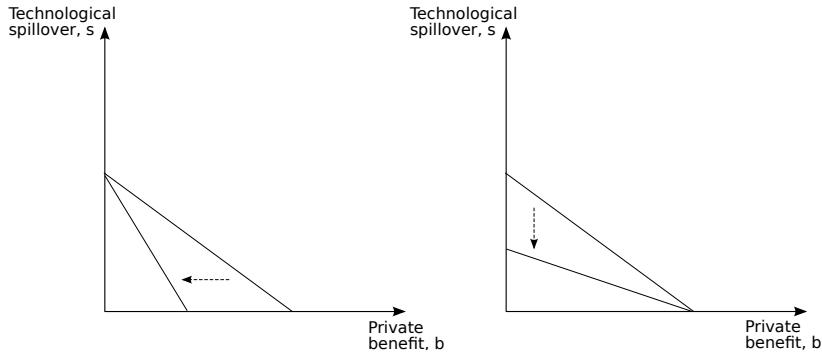
Model: parameters of the constraint

‘‘Price” of spillover
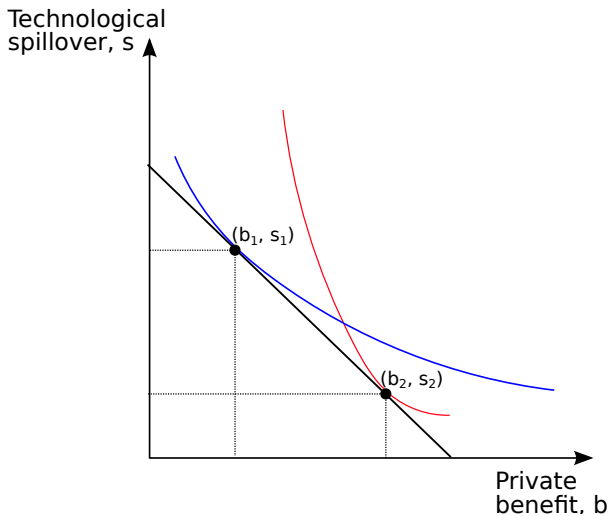“Price” of private benefits

Model: parameters of the constraint

Model: parameters of the constraint

Model: utility

Model: What are the assumptions?

1. The firm only cares about its bottom line

Model: What are the assumptions?

1. The firm only cares about its bottom line
2. The firm is profit satisficing.

Model: What are the assumptions?

1. The firm only cares about its bottom line
2. The firm is profit satisficing. (Can be relaxed in two-sided matching model)

Table of Contents

Project 1—"price" of spillover

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

Project 1—"price" of spillover

- H: Officials extract spillover from firms with high potential for spillover and get bribes from the others
- Empirical strategy: Instrument for *spillover potential*

Project 1—"price" of spillover

- H: 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 instrument: the weak instrument issue is there but can be tested

Project 1—"price" of spillover

- ► H: 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 instrument: the weak instrument issue is there but can be tested
  - ► Question: Data from any other country that can be used to estimate spillover?

Project 2—"price" of private benefits

- ▶ H: Officials extract bribes from firms for whom it costs less to bribe

Project 2—"price" of private benefits

- ▶ H: 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

- H: Officials with a short time horizon prefers private benefits over bribe

Project 3—the official's utility function

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

Project 4—two-sided logit matching

- H: Officials with a short time horizon prefers private benefits over bribe

Project 4—two-sided logit matching

- H: Officials with a short time horizon prefers private benefits over bribe
- Empirical strategy: two-sided logit

Project 4—two-sided logit matching

- A many (firms)-to-one (country) matching problem

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

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

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

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?

Ahlquist, J. (2006). Economic policy, institutions, and capital flows: portfolio and direct investment flows in developing countries. *International Studies Quarterly 50*(3), 681–704.

Guisinger, A. (2009). Determining Trade Policy: Do Voters Hold Politicians Accountable? *International Organization 63*(03), 533.

Havranek, T. and Z. Irsova (2011). Estimating vertical spillovers from FDI: Why results vary and what the true effect is. *Journal of International Economics 85*(2), 234–244.

Jensen, N. M. (2003, jul). Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment. *International Organization 57*(03).

Li, Q. and A. Resnick (2003). Reversal of fortunes: Democratic institutions and foreign direct investment inflows to developing countries. *International organization*.

Pandya, S. (2008). *Trading spaces: The political economy of foreign direct investment regulation*.

Pinto, P. (2013). Partisan Investment in the Global Economy.