Latin America: Does the amount of international agreements influence the inflow of foreign direct investment? Comparing analyzes on the data.

*Marcelle Amaral[1] - UFPE*

Resume

Does the amount of international agreements influence the inflow of foreign direct investment in Latin America? Under the theoretical framework of political and economic proximity in the region, a greater number of Bilateral International Treaties (BITs), Preferred Trade Agreements (PTAs) and GATT / WTO participation have a positive effect on the inflow of investment. foreign direct (FDI). For the analysis, we use a multivariate regression model with fixed effects for countries and panel data that receive different treatments for the same model, comparing the differences of techniques. As a main result, it is found that the higher number of PTAs positively influences the inflow of FDI in the region.

1. Introduction

This paper aims to insert the debate on the importance of political economic analysis in the regional framework for receiving foreign direct investment (FDI). Developing countries saw, between 1970 and 2007, growth in the number of Bilateral International Treaties (BITs), the number of Preferred Trade Agreements (PTAs) and the inflow of FDI. Within this clipping is Latin America.
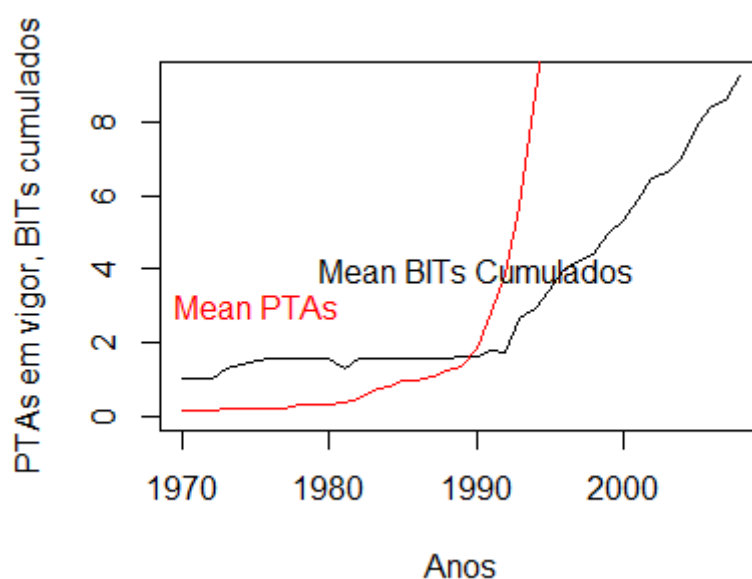
The influence of a set of regional factors is expected to be effective in bringing results closer to Latin America, framing it in developing countries with close characteristics. Although most of the analyzes adopted in the literature are economic, this analysis is based on the sum of political factors to analyze the influence of PTAs and BITs on the inflow of FDI, hoping that these factors reinforce the causal mechanism that links the variables in question.

This article consists of seven sections: (1) Introduction, (2) Literature Review, (3) Theory, (4) Research Design and Data, (5) Results, (6) Implications and Conclusions, and (7) References.

2. Literature Review

The amount of foreign direct investment inflows increased dramatically from 1980 to 2007 (UNCTAD, 2010). Not only has the amount of investment received, but the number of bilateral and multilateral international agreements

has increased since the 1970s in developing countries (BÜTHE and MILNER; 2008; UNCTAD, 2003). The justifications for these increases are diverse.

Figure I.1. FDI inflows, globally and by groups of economies, 1980–2009
(Billions of dollars)
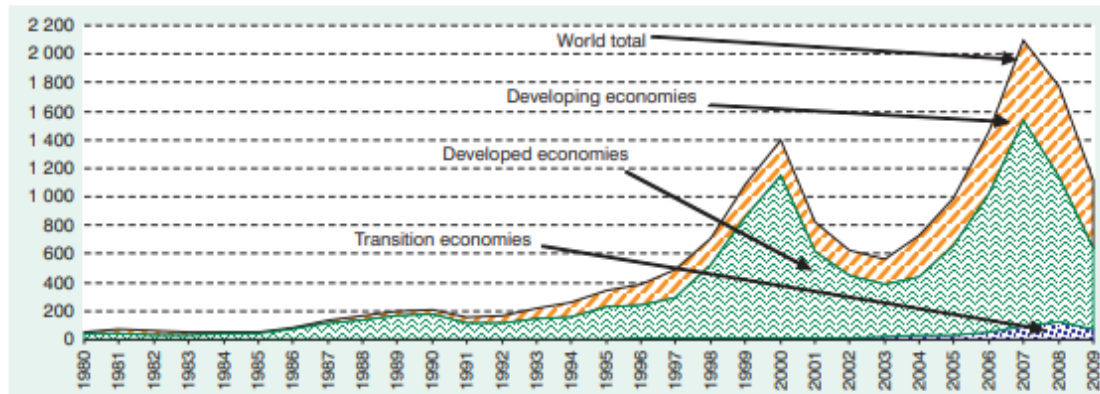
Source: UNCTAD, based on annex table 1 and the FDI/TNC database (http://www.unctad.org/fdistatistics).

From a micro perspective, ie, considering individual characteristics of companies, there is a heterogeneity inherent in the new business models that underlie their participation in investments and foreign trade, linked to the organizational qualities of companies. There are only a small portion of exporting companies and these tend to be more productive than those in the domestic market (EKHOLM, FORSLID AND MARKUSEN, 2003), and there are only a small portion of FDI engaged companies and these tend to be more productive than which exporting companies (HELPMAN, 2006).

The consequence of business heterogeneity is reflected in a relativization of the division of FDI into vertical and horizontal, as large multinationals invest in low-cost countries by creating export platforms to build a worldwide distribution network from capital flows between developed countries could not be classified only as horizontal (HELPMAN, 2006).

There is little evidence in the literature that FDI relates to differences in country production factors, risk diversification or tax evasion. What would be the advantage, then, of a multinational performance rather than a single country? Dunning's frame (1977, 1981) proposed the property, locational advantage and internalization (OLI) model, that is, it is located in another country would allow the multinational to enjoy advantages such as ownership of the production process and the product by obtaining patents. and trademark registration; proximity and

access to customers; in addition to tariffs and quotas and internalization advantages such as participation in licensing agreements.

Thus, multinational companies can be defined as FDI firms, ie investments in which there is a substantial interest in a foreign company or the creation of a subsidiary in a foreign country, confusing both terms (MARKUSEN, 1995, p. .170).

In addition to their own corporate structure and organizational quality, governments would act in the process of stimulating FDI and could change and influence the institutional environment, giving investors credibility in investments. This includes the two main instruments for attracting foreign direct investment: PTAs and BITs.

Regarding PTAs, one of the solutions found to the transnational institutional problem is that multinational companies are able to adapt to the institutional environments of each country and receive adequate incentives from local governments for activities of interest to be developed (HALL and SOSKICE, 2001).

In relation to BITs, they allow governments credible commitments to increase treaty noncompliance costs above what they would have been without treaty (ELKINS, GUZMAN and SINMONS, 2008). Investors' perception of credibility will vary in several ways, one of which is corruption. The more corrupt a country, as measured by investor perception of corruption, the greater the need to attract investors through BITs, for example (ELKINS, GUZMAN and SINMONS, 2008).

PTAs and BITs follow different logics depending on the development status of countries. The reasons for engaging in one or the other change. Developing countries, for example, would have the incentive to hold BITs and PTAs to attract IDF and increase trade, and would sign these agreements to meet policy goals, enhancing human rights and strengthening democracy (Tobin & Busch, 2010).

The justification is different for developed countries. They have an interest in BITs with developing countries as an institutional guarantee against

possible expropriations and an interest in PTAs for providing an institutional environment for multinationals that reduces costs, for example in the vertical production chain, with its division into different countries, using the exportation of inputs in their favor in the production chain (Tobin and Busch, 2010; Helpman, 1984; Helpman and Krugman, 1985).

The literature is divided on the effects of treaties on foreign investments. Regarding the positive impact of BITs on IDF, Hallward-Driemeier (2003) finds no evidence that one positively influences the other, UNCTAD (1998) states that there would be a small positive relationship between them. Egger and Pfaffermayr (2004) find a positive and significant effect on ratification of BITs in real FDI stocks. Tobin and Rose-Ackerman (2005) find a negative effect for developing countries when risk levels are very high. Salacuse and Sullivan (2005) find a positive effect for the United States and not for other OECD countries.

Neumayer and Spess (2005) find a positive effect of BITs on foreign investment flows, arguing that there is a return for developing countries to accept the demands and trading costs of BITs, which can sometimes act as a substitute for BITs. poor institutional quality in some countries.

Economic literature points out that market size in the host country, levels of economic development and economic growth matter for FDI. Not only that, political factors such as political stability and violence influence the country's level of attraction for investment (BRUNETTI, KISUNKO and WEBER, 1997; JUN AND SINGH 1996; SCHNEIDER AND FREY 1985).

Research into whether regime types influence a country's attractiveness for investment also differ. Some indicate that multinationals would prefer autocratic governments because they suppress labor demands and provide political certainty with the absence of electoral processes (O'DONNEL, 1979). And some indicate that democracies would attract more investment than non-democracies (FENG 2001; JENSEN 2003, 2006).

Regarding PTAs, researchers suggest that their increase in the country can attract foreign investment from third parties, generating investment diversification (DEE AND GALI 2003, TUMAN AND EMMERT 2004). They can also help developing countries by signaling competitiveness in economic sectors,

liberal political orientation, or lasting peace relations (FERNANDES and PORTES, 1998).

Büthe and Milner (2008) argue that trade agreements institutionalize commitments to liberal economic policies, and the PTAs are a representative form of this by internationally and publicly engaging a country's engagement, embedding it in a WTO trade liberalization framework and subjecting it to compliance with monitoring rules, which would be sufficient to increase the flow of investments in developing countries.

Thus, it can be seen in the literature, research dealing with the inflow of foreign direct investment under different approaches. From a micro perspective, it relates it to individual company organizational choices and market incentives, making the vertical and horizontal FDI dichotomy obsolete.

From a macro perspective, it presents it from a domestic and international point of view. There are domestic institutional economic incentives, such as advantages to multinationals, a credible environment for governments, institutional quality, corruption rates, legal tradition, political stability, which encourage the inflow of FDI.

This reception in the international arena is subdivided into two spheres, bilateral and multilateral. BITs are forms of inflow of FDI that pertain to bilateral international relations with various logics the signing of treaties between developed and developing countries. PTAs are another form of receiving FDI within the context of international multilateralism, also studied in the literature under the development / developing dichotomy.

In the literature, there is a scarcity of regionally focused analyzes that relate the inflow of FDI to the signing of these treaties and consider political aspects, different from economic ones (PENFOLD, 2003; WILLIAMS, 2015) or make this cut within a country framework. under development. There is evidence from the literature review here of Latin American characteristics that could encourage the inflow of FDI through BITs and PTAs within the logic of developing countries. The question then is whether the participation of Latin American countries in PTAs and BITs, as an international commitment, was effective in attracting foreign investment.

In addition, the following justifies the importance of an analysis for the region.

3. Theory

This article reinforces MAINWARNING and PÉREZ-LINÃN's (2008) defense of the importance of studying the regions, not as the main unit of analysis in political science, but as a unit of substantive analysis that is sometimes overlooked. Regions would be important for understanding patterns in world politics and international relations (GLEDISTSCH, 2002).

The first point is that the literature, in analyzing and searching for the causes and justifications of receiving FDI through BITs and PTAs, subdivides them into developed and developing countries by justifying different logics for signatures of these treaties depending on the level of development. This is a valid parameter and this article is not concerned with refuting it, but in adding that the logic of receiving FDI in developing countries disregards regional specificities. Thus, "different regions may have distinct and systematic causal patterns that may be obscured by the assumption of causal homogeneity" (MAINWARNING and PÉREZ-LINÃN, 2008, p. 524).

The second point is the ability of political development in a country to affect neighboring countries and a region. If the unit of analysis ignores regional processes, it ignores causal processes. Latin America is thus a region, built symbolically, in the perception of common sense, and not subject to constant change, which serves as a unit of regional analysis (MAINWARNING and PÉREZ-LINÃN, 2008).

The methodological approach of verifying the particular dynamics of a region should be made through a comparison with other regions or with a larger set of cases (MAINWARNING and PÉREZ-LINÃN, 2008, p. 555). The second is adopted. Within developing countries, there are theoretical regional specificities that lead us to predict the intensification of a positive relationship between FDI, BITs and PTAs. Do not reject the causal mechanism that in developing countries the number of PTAs and BITs encourage the inflow of FDI. On the contrary, the regional clipping is used to reinforce it before testing.

Studies analyzing developing countries show a positive effect of factors in relation to FDI for certain common characteristics, such as language. FDIs tend to be higher in countries with a common language, facilitating communication, linked to legal systems and culture (MELITZ and TOUBAL, 2014 and FENG et al., 2019). They tend to be more received in democracies (JENSEN, 2006), suffer different influences depending on legal traditions (LA PORTA, 2007), all characteristics not homogeneous to developing countries, but common to most Latin American countries.

The adoption of international institutions such as PTAs and BITs already serves to increase the flow of FDI in developing countries by providing credibility by institutionalizing a country's commitment to the world market, making it easier to punish it for non-compliance, and by putting pressure on non-compliances, justified by reciprocity policies (BÜTHE and MILNER, 2008).

This institutional context is reflected in international agreements as an alternative to post-war change in international trade rules, in which bilateral and regional agreements can foster multilateral negotiations, foster a conciliatory environment and allow for a world order of integrated negotiation. with adherence to organisms such as GATT and WTO (WTO, 2011).

Expectations are that, as they are designed for production networks, and regionalism favors networking, there would be geographic concentration of trade over time, confirmed by the growth of predominantly exporting developing regions (WTO, 2011), also common to Latin America.

This argument then justifies testing the following hypotheses for Latin American developing countries:

I. Higher number of PTAs, increase the inflow of FDI;

II. More BITs increase the inflow of FDI;

III. Being a member of the GATT / WTO increases the inflow of FDI;

4. Research Design and Data

In order to establish the research design, it is important to define the measurements of our dependent and independent variables.

Foreign Direct Investment (FDI) is a long-term investment made by an investor, whether a company or an individual, who is in a different economy from the one he invests. It is received by a company and involves significant investor interest and control over its management and management (UNCTAD, 2007, p. 245).

FDI comprises three main components: (i) share capital, the purchase of shares by an investor from a listed company in a non-resident country; (ii) reinvested earnings, whether from company shares or otherwise earned earnings; and (iii) loans between parent companies - direct investors - and their subsidiaries (UNCTAD, 2007).

They are calculated in flow or in stock. This article will focus on investment flows that involve both capitals sent by a foreign investor to a company and, capital received by an investing company. (UNCTAD, 2007).

Preferred Trade Agreement (APCs) is a unilateral preference agreement within the general system of preferences between developed and developing countries, offering developing countries preferences for goods imported from developing countries (WTO, 2011). There are only signed and signed PTAs and in force, in this article, we are interested in the second, which is capable of legally binding agreements, and therefore, signals of greater credibility for investors than the merely signed (BÜTHE and MILNER, 2013).

Bilateral investment agreements are agreements between two countries concerning the promotion and protection of investments made by investors from their countries in the other's territory (UNCTAD, 2019). The basic provisions of an ILO are a standard of treatment for foreign investors as if they were domestic, which fits in with the treatment of the most favored nation, that is, the privileges granted to an investor are extended to all, taking as a parameter a international standard and protecting foreign investors from political risks in developing countries (NEUMANN and SPESS, 2005). Investors end up getting better treatment than nationals (VANDEVELDE, 1998).

The model adopted in this paper will be one developed and used by Büthe and Milner (2008) on the flow of foreign investment received by developing countries. The countries under analysis all have more than 1 million inhabitants, add 20 and belong to Latin America. The analysis is a panel time series from 1970 to 2007. In summary, the model is the linear regression (OLS) model in transverse time series with fixed effects for countries.

To combat the spurious correlation problem, i.e. regressing a dependent variable with a trend into an independent variable, a linear function is applied to remove the trend of the variables over the years. To deal with heteroscedasticity or autocorrelation in errors, standard errors in the model are used by Arellano (1987) estimators, defended by the authors as robust for heteroscedasticity or autocorrelation, allowing conservative inferences (BÜTHE AND MILNER, 2008).

Regarding the type of technique used to remove the upward trend of variables by applying the GIM[2] test in the regression models, King and Roberts (2014, p. 174) argue that the process used by Büthe and Milner (2008) to remove the trend was linear when some countries had quadratic trends. In addition, the same trend was applied to all countries, which would not be ideal in a sample that encompasses a large heterogeneity of countries.

The linear technique used by Büthe and Milner (2008) would induce the intensity of the relationship between the variables. As countries have very different standards between them, the main problem would be to apply the same technique to all countries, as if they were uniform.

King and Roberts (2014) remove the quadratic trend of the time series, and after withdrawal, the test is no longer significant. Nonlinear withdrawal of the trend for each country rather than for all alters the significance of the relationship between the variables. The impact of this remodeling on the results is that the variables of interest are no longer significantly correlated with FDI inflow.

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[2] GIM test was developed by the authors as a "generalized information matrix" (GIM) test, serving as a single, simple and formal measure that measures the difference between robust and classic standard errors in parametric models (KING and ROBERTS, 2014, p. 166).

In view of the above, we used the methodology of different detrends, pointed out by Büthe and Milner and King and Roberts, in the treatment of data and for each country, to compare the difference of these treatments based on the theoretical assumption that these data. closer to Latin America, which would minimize possible effects of heterogeneity in its treatment. By testing three models, it was also possible to analyze the assumptions and identify which one best suited for greater reliability in the results.

The dependent variable is the annual inflow of FDI as a percentage of GDP, capturing FDI as a function of GDP (Jensen 2006; Jun and Singh 1996; Neumayer and Spess 2005). The effect of international institutions is captured by the dichotomous variable participation in the GATT / WTO. The independent variable is current PTAs, a measure of the total number of PTAs signed by the host country and restricted cumulative BITs. To control political factors and domestic policy constraints, we use respectively the measure provided by Arthur Banks and Henisz with the number of vetoes in a national political system (BÜTHE AND MILNER, 2008).

The adopted model is presented below:

$$\text{IEDit} = \alpha + \gamma1 \text{ (Market Size) i (t − 1)} + \gamma2 \text{ (Economic Des.) I (t − 1)} + \gamma3 \text{ (GDP Growth) i (t − 1)} + \text{(current PTAs) i (t − 1)} + \text{(GATT / WTO) i (t − 1)} + \text{(cumulative BITs) i (t − 1)} + \text{(POLCON) i (t − 1)} + \text{(install inst.) i (t −1)} + \delta i + \varepsilon it,$$

where δi indicates fixed country effects implemented through a set of n - 1 country dummies.

The data

When analyzing FDI flow data provided by the UNCTAD collection method, account should be taken of its limitations. The data were calculated on a net basis where the credits of capital transactions minus their debts between investors and their foreign affiliates equals a country's FDI flow, for example. Net reductions in assets (FDI outflows) or net increase in liabilities (FDI inflows) are recorded as credits, and therefore positive in the balance of payments, while net asset increases or net reductions in assets are recorded as debits, and balance of payments. In the end, if the FDI flow is negative, it is concluded that the sum

of the three investment components was negative, which symbolizes a situation of divestment or reverse investment (UNCTAD, 2007).

The original database was taken from another article by Büthe and Milner (2014) for developing countries and expanded on variables and numbers from the 2008 article. The database used allows differentiating between signed and current PTAs, and provides data for developing countries from 1970 to 2007, longer than the model estimated in the first article (BÜTHE and MILLNER, 2014, p. 99).

5. Results

The first model is generated without any treatment in the data trend. The intercept is a prediction if the response value of the independent variables is 0 and indicates where the line crosses the y axis. It serves to ensure that the residuals have an average of 0 and a better fit of the model, without a meaning in the model. model.

For model 1, there is a positive and statistically significant relationship for the number of PTAs, the number of BITs and the GDP growth. Controlled by the effects of the other variables of the model, it is interpreted that a 0.19% increase in GDP in FDI inflow is expected for each new treaty. This effect was statistically significant at 0.001, indicating that the probability of the hypothesis that there is a relationship between the increase in PTAs in the increase in IEDs would be valid in 99 for every 100 cases of the model.

Regarding the number of BITs, the relationship between the variables was even stronger and less than 1% the probability that the hypothesis was not true. It is observed that there would be an increase of around 0.045% in GDP in FDI inflow for each new ILO, controlled by the effects of the other variables.

In relation to GDP growth, the ratio was also extremely statistically significant, indicating that in less than 1 case per 100, there would be no relationship between receiving FDI and a country's GDP growth, controlled by the effects of the other variables. There would be a 0.07% increase in GDP in FDI inflow for every 1% increase in GDP.

Regarding the other variables of the model, it is noteworthy that political instability and economic development have a negative relationship with the dependent variable, signaling opposite trends regarding the inflow of FDI. Although statistically significant, political instability at the addition of one unit, controlling for the other effects, causes a 0.02% reduction in the percentage of GDP in inflow of FDI, as would ceteris paribus, a reduction of 0.33. % to receive FDI as economic development increases.

For model 2, with the linear detrend, there is a positive relationship, no longer statistically significant, for the number of PTAs. Being a GATT or WTO participant now has a statistically significant effect to 5%, i.e., the probability of the hypothesis that participating in the GATT / WTO increases the inflow of FDI is 95 times for every 100 that the model is. the same reasoning can be applied to the political instability variable with a negative effect for receiving FDI. Thus, the marginal increase in political instability leads to a 0.04% reduction in the percentage of GDP received from FDI, controlled by the other effects.

The number of BITs and GDP growth are also statistically significant, but at a level of 99%. A marginal increase in BITs, controlled by the other effects, causes a positive change in the dependent variable by 0.06% and a marginal increase in GDP growth, ceteris paribus, causes a positive change in the dependent variable by 0.05%. The hypothesis that the increased number of BITs generates more FDI inflow is probable at 99 per 100 hypothesis tests.

Moreover, despite the significance, the size of the market and the economic development of countries are negatively correlated with the inflow of GDP in this model, ie, the larger the market size and economic development, the smaller tends to be. be the inflow of FDI by countries.

The model with the best fit to assumptions is 3. By running it only 2 variables maintains statistical significance: PTAs and GDP growth. The marginal increase in the number of PTAs in effect, controlled by the other effects, generates a 0.29% increase in the percentage of GDP related to the inflow of FDI. GDP growth, which in the previous model is positively correlated to the dependent variable at a significance level of 95%, is now at a significance level of 99%, suggesting that an increase in the accuracy of the correlation probability.

Market size and economic development that were negatively correlated with the dependent variable now correlate positively. Participation in GATT / WTO also has a negative relationship with the inflow of FDI, contrary to the positive and statistically significant of the previous model.

Testing the hypotheses for each model, model 1 supports the hypothesis that an increase in PTAs and BITs increases the inflow of FDI, participating in the GATT / WTO has a positive but not statistically significant relationship. Model 2 supports the hypothesis that participating in the GATT / WTO and increasing the number of BITs would increase the inflow of FDI with statistical significance. For the number of PTAs, the relationship is positive, but not significant.

Finally, model 3 maintains that only the increase in the number of PTAs, with statistical significance, influences the inflow of FDI by Latin American countries. Participation in the GATT / WTO is negatively related to the inflow of FDI and the number of BITs, despite being positively related, has no statistical significance.

In all models, GDP growth is positively and statistically related to the inflow of FDI, which could not be different because the dependent variable is measured as a percentage of GDP.

6. Implications and Conclusions

The models presented and tested here followed a logic of treatment of diverse data and exposed in two articles. Büthe and Milner's (2008) linear detrend model for developing countries found results in which cumulative PTAs, GATT / WTO participation, and BITs positively and significantly impacted the inflow of FDI, as a percentage of GDP, by 122 developing countries from 1970 to 2000.

The model performed with a quadratic detrend by King and Roberts (2014) found no statistical significance for the hypotheses, finding the result that participating in the GATT / WTO would decrease the inflow of FDI rather than increase it. The clipping was to all developing countries.

The purpose of this paper was to test whether these conclusions would remain or change depending on the application of the model to developing Latin

American countries, which are closer in various theoretical aspects and often not analyzed as a regional bloc. If the theoretical aspects reinforce the causal mechanism within the logic of developing countries, the use of the best would be expected, results that reflect this.

The results allowed the visualization and comparison of the models, as well as the perception of data treatment in the model results. It is important to highlight the difference of analysis of assumptions for the selection of a model. In the specific case, the model that passed the assumptions test the most was the 3, with quadratic detrend. Thus, selecting the most appropriate model concludes for the countries of Latin America.

Like King and Roberts (2014), when estimating the three models only in the last one, participation in GATT / WTO starts to negatively correlate with the increase in FDI. However, in this same model, statistical significance is found for the number of PTAs in effect, i.e., increasing the number of PTAs would generate one in the IED receiving stream.

Thus, somehow developing countries in Latin America behave differently compared to all developing countries in the time spectrum from 1970 to 2007, with the growth of PTAs having a positive and significant effect on increased FDI inflow. This conclusion requires further investigation and further testing,but signaling a regional aspect that can be reflected in the data.

7. References

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