

Chapter 12. The Political Economy of Foreign Direct Investment: Democracy, Economic Crisis, and Domestic Audience Benefits

Abstract

Chapter 12 looks at what makes democratic countries attractive to multinational corporations. The existing literature points to domestic audience costs--that is, the costs of upsetting a domestic audience as a result of inconsistent policies. Because they are subject to electoral sanction from those citizens who may be discontented with arbitrary policy changes, democratic leaders are likely to make credible and consistent investment commitments to foreign investors, irrespective of domestic political and economic conditions; the thinking goes, therefore, that democracies are more likely to attract foreign direct investment (FDI) than are nondemocracies. However, the literature seems largely unaware of the potential for domestic audience benefits--that is, the possibility that a democratic leader may use a national economic crisis to his or her electoral advantage by scapegoating foreign firms (i.e., reneging on investment deals and expropriating output or capital); this move would ultimately discourage inflows of FDI. Built on a cross-sectional, time-series data analysis for 70 developing countries during the period from 1980 to 1995, this study finds that democratic developing countries in economic crises are associated with decreased inflows of FDI.