

Is civil unrest bad for business? Source-country politics & FDI

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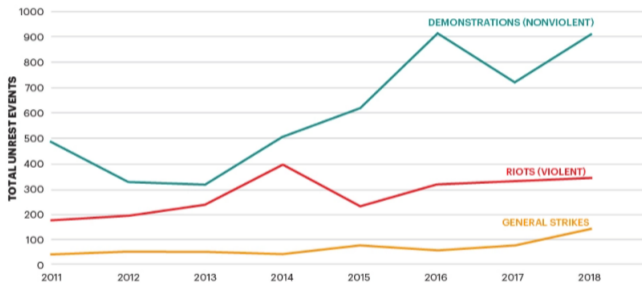
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Civil unrest on the rise



Global trends in civil unrest, 2011–2018



Source: Cross-National Time Series (CNTS), IEP calculations





- ▶ What are the consequences of civil unrest for FDI?
 - ▶ Does the effect vary by income group?
 - ▶ Does the effect vary by regime type?

- ▶ Many other reasons to care about these protests, but:
 - ▶ FDI critical to economic growth, development, etc.
 - ▶ Key question for investors & insurers

Two strains of literature with opposing conclusions

1. Source-country politics as predictors of outward FDI

- ▶ Escapism: If conflict worsens in the source country, FDI will increase because investors will want to get out (Kayam 2009, Das 2013)
- ▶ Most of the literature focuses exclusively on China & India
 - ▶ → If civil unrest in the source country increases, outward FDI will also increase

2. Financial outcomes of civil unrest

- ▶ Civil unrest is bad for financial markets (Barrett et. al, 2021; Espinosa-Mendez, 2021)
- ▶ Conflict is bad for firm productivity (Klapper et. al, 2013)
- ▶ Labor unrest is bad for corporate performance (Ganda and Ngwakwe, 2015)
 - ▶ → If civil unrest in the source country increases, outward FDI will decrease

On the whole, I expect civil unrest to decrease outward FDI

- ▶ Civil unrest increases climate of uncertainty
- ▶ Civil unrest hurts firm productivity—can affect labor force; property; access
- ▶ Civil unrest can raise operating costs

Democratic institutions mitigate the effect of civil unrest on outward FDI

- ▶ Much more uncertainty with civil unrest in non-democracies → (adverse) regime change? escalation from unrest to civil war? (Trejo, 2012)

High-income countries are less likely to have civil unrest decrease outward FDI

- ▶ High-income countries more tolerant of uncertainty generally (Hancioglu et. al, 2012)

Example: Petrobras (Brazil)

Strikes, work stoppages or labor unrest by our employees or by the employees of our suppliers or contractors could adversely affect our results and our business.

Disagreements on how we manage our business, in particular divestments and their implications for our personnel, changes in our strategy, human resources policies regarding remuneration, benefits and headcount, employee contributions to cover the deficit of our pension plan, implementation of regulations recently created relating to health and pension plans and changes in labor law may lead to judicial inquiries, labor unrest, strikes and stoppages.

Strikes, work stoppages or other forms of labor unrest at any of our facilities or in major suppliers, contractors or their facilities or in sectors of society that affect our business could impair our ability to complete major projects and impact our ability to continue our operations and achieve our long-term objectives.

Our success also depends on our ability to continue to train and qualify our personnel so they can assume qualified senior positions in the future. We cannot assure you that we will be effective in training and qualifying our workforce sufficiently, nor that we will be able to achieve this goal without incurring additional costs. Any such failure could adversely affect our results and our business.

Figure 1: Item 1A "Risk Factors" in 10-K

H1: Civil unrest decreases outward FDI.

H2: Democratic institutions mitigate the negative effect of civil unrest on outward FDI.

H3: Economic development mitigates the negative effect of civil unrest on outward FDI.

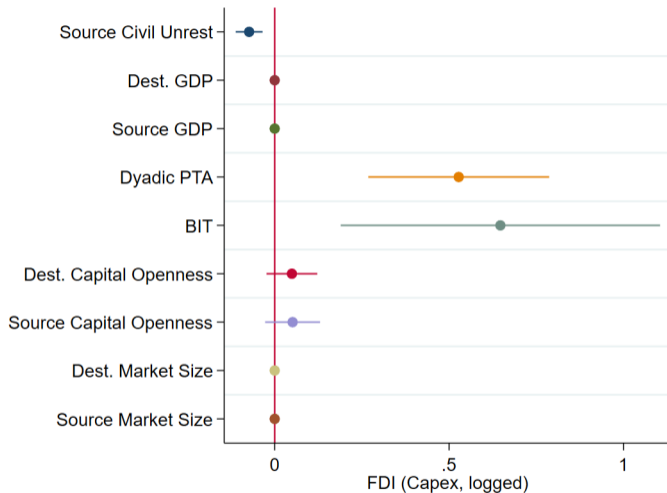
- ▶ Sample: Greenfield FDI to all developing countries, 2003-2017
- ▶ Unit of analysis: (directed) dyad-year
 - ▶ Critical to use dyadic analysis to properly account for the role of PTAs & BITs
- ▶ Number of observations: 559,000
- ▶ **Dependent variable:** FDI, measured as logged capex (source: fdiMarkets)
 - ▶ Why capex? (Kerner 2014)
- ▶ **Independent variable:** Civil unrest (source: ICRG)
 - ▶ **Civil unrest:** Risk of mass protest, such as anti-government demonstration or strikes

- ▶ **Dyad** PTAs, BITs
- ▶ **Destination country** Market size (logged), GDP (logged), Capital Openness, Regime type
- ▶ **Source country** Market size (logged), GDP (logged), Capital Openness, Regime type
- ▶ **Robustness** Inflation, regime durability, coups, exchange rates, trade as % of GDP



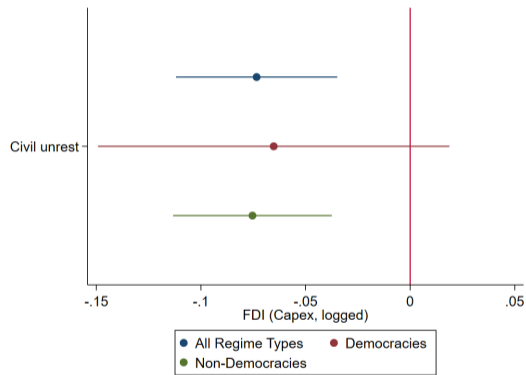
- ▶ OLS panel regression with dyad and year fixed effects
- ▶ All independent variables lagged by one year to account for the fact that investment decisions are not immediate
- ▶ Lagged endogenous variable to account for any temporal dependence in the data

H1: Civil unrest decreases outward FDI

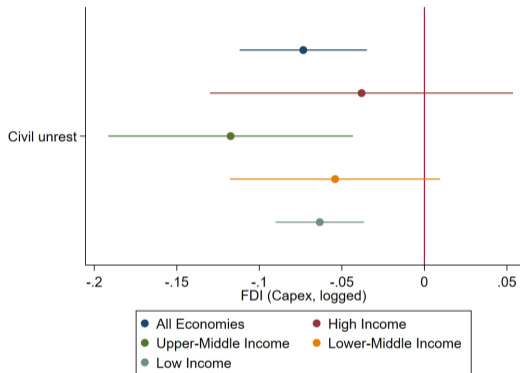


Effect size = equivalent to loss of \$1 million (USD) in capex per dyad

H2: Democratic institutions shield firms



H3: Firms in emerging markets affected most



Nearly double effect size in upper-middle income countries → equivalent to loss of \$2 million (USD) in capex per dyad

Time-series

- ▶ Neither the dependent variable (FDI) nor the main independent variable of interest (civil unrest) have a unit root (trend-stationary)
- ▶ As the statistical tests for unit roots are known for having low statistical power, I employed a battery of them, including Dickey Fuller, Levin-Lin-Chu, and Harris-Tzavalis.

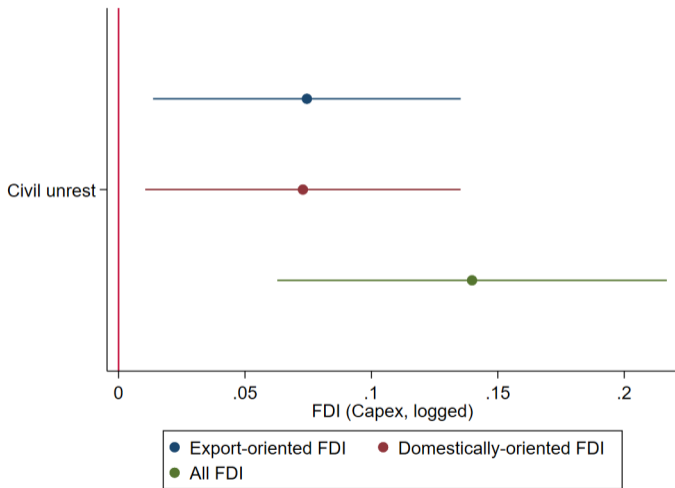
Endogeneity

- ▶ Lagged endogenous variable
- ▶ FDI is not a statistically significant predictor of civil unrest

Confounders

- ▶ Robust to many additional controls, including trade as a % of GDP, exchange rate, inflation, regime durability, unemployment, coups

Robustness: Sector effects not driving results



Contributions



- ▶ Furthers debate re: role of source-country politics in outward FDI
- ▶ Utilizes measure of FDI more suited to the theory
- ▶ Better identification through dyadic research design

Implications

- ▶ Growing civil unrest may mean less FDI to developing countries
- ▶ In turn, less development/jobs/technology spillover

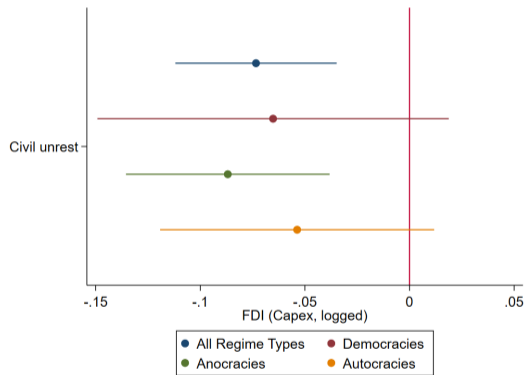
Future research

- ▶ Event study of episodes of civil unrest, including thematic analysis
- ▶ Spatial diffusion analysis of unrest contagion



Thank you!
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Regime type: more detail



Countries in sample

- ▶ 139 developing countries
- ▶ I operationalize this as countries that are not classified as "high income" by the World Bank.

