

Master's thesis

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Science and Technology  
Faculty of Social Sciences  
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## Political Regimes and FDI

An Empirical Analysis of the Attractiveness of  
Hybrid Regimes for Multinational Companies

Master's thesis in Political Science  
Trondheim, Spring 2012

# **Political Regimes and FDI**

*An empirical analysis of the attractiveness of hybrid regimes for multinational companies*

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**Master of Political Science**

**Master Thesis Submitted to the Department of Sociology and Political Science**

**Norwegian University of Science and Technology**

**Trondheim, June 2012**



## **Acknowledgement**

Although I am solely responsible for any errors, this thesis would never have been feasible without the guidance and encouragement of an important group of people. First and foremost, it is with immense gratitude that I acknowledge the support and help provided by my supervisor Jo Jakobsen. He has far exceeded my expectations for a supervisor, with both providing a valuable dataset, and guiding me through the process of writing a thesis. I would also like to thank my classmates with whom I have shared two great years, at times stressful, but mostly joyful. Last, but not least, this thesis would not have been possible without the backing and assurance provided by both my parents and my one and only Charlotte Ystenæs.



## **Abstract**

This thesis set out to investigate the relationship between political regime type, and FDI inflow. The academic field has seen a fair amount of research in recent years, but this is usually limited to the likes of democracies and autocracies. I argue that many countries are neither of these two, but find themselves in a political unstable gray zone in between, called hybrid regimes. This thesis draws on a comprehensive dataset ranging from 1980-2010, and by way of time-series cross-section analysis; it sets out to explore the attractiveness of hybrid regimes in relation to FDI inflow. The findings indicate that unstable political regimes do attract MNCs, but that they usually are dependent on natural resources. Hybrid regimes receive more FDI inflow than autocracies, but less than democracies. The thesis also find that the region Africa is special in that hybrid regimes are the biggest recipient of FDI inflow, with natural resources being the main factor. The findings support the former literature saying that democratic conditions attracts MNCs, but also question the alleged democratic transition taking place in a growing oil-dependent world.



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# 1. Introduction

The year is 2012, the oil market is stunned; the democratic state of Argentina decides to seize an affiliate of the Spanish oil company *Repsol*, expelling its executives from their offices and announcing that they will pay far less than the \$10.5 billion being demanded in compensation (Forero, 2012). The nationalization of old state-owned companies has been common in recent years in countries like Bolivia and Venezuela, but it was not expected to happen in Argentina. On a different note, the U.S. mining company *Newmont Mining Company* are in 2007 forced out of the autocratic state of Uzbekistan after an unexpected change in tax regulations that gives them a bill of \$48 million. The Uzbek froze their assets in the country and forced a state-led takeover (James, 2007). Moreover, in November 2011, three employees belonging to the U.S. oil giant *Chevron* is kidnapped from a vessel outside the hybrid state of Nigeria. The attack is just one of many carried out in the last decade by local guerrilla groups that demand more in return from the oil industry (Vanguard, 2011). These three examples represent the broad subject of this thesis: challenges multinational companies (MNCs) meet in dealing with foreign markets, both in democratic, autocratic, and hybrid regimes. The narrower question of this thesis is: what political regime type attracts most foreign direct investment (FDI) inflow?

By way of time-series cross-section analysis, this thesis seeks to explore the relationship between foreign direct investment inflows and political regime type. The end of the Cold War started both a wave of democratization and a sharp increase in investments made across borders (Hill 2011). This has given rise to the notion that democracy enhances economic growth and prosperity, but is it the most attractive regime type for MNCs? The debate is ongoing between the sides that argue for autocracy and democracy. Olson (1993) argues that democracies provides most economic and political stability for MNCs. This is provided through a strong and effective government, with several veto players present who create a checks and balances (Tsebelis 1995). Jakobsen (2012) stresses the importance of a well functioning rule of law, which provide security and predictability for MNCs through the protection of property rights. O'Donnell (1978) is among those who argue that autocracies are best suited for foreign investment, mainly because of the executives' opportunity to provide economic incentives for foreign firms. The government in autocracies can also repress their population, with a low-cost labour force being one condition which can attract MNCs (Oneal

1994). The debate between these two sides is ongoing, but still no scholars have explored the relationship between FDI inflow and hybrid regimes;

...what is often thought of as an uneasy, precarious middle ground between full-fledged democracy and outright dictatorship is actually the most common political condition today of countries in the developing world and the post communist world. (Carothers 2002: 18)

Hybrid regimes are characterized as the states that find themselves in the sphere between democracy and autocracy; they are often called states with democratic deficiencies. This group is broad and complex in that it has many different states with its own unique governmental set-up (Boogards 2009, Diamond 2002, Diamond & Morlino 2004, Merkel 2004, Morlino 2009, Wigell 2008). Many authors have described what they see as a broad transition towards democracy for these states, but Carothers (2002) argues that hybrid states are not on a road towards democracy, but should be regarded as a new regime type. The thesis seeks to explore the relationship between foreign direct investment (FDI) inflows and this regime type. It will draw on theory exploring hybrid regimes within other fields of research, and connect this to foreign direct investment. Among these is the article by Gates et.al. (2006), which investigates the relationship between political regime type and civil wars, finding that hybrid regimes are more prone to this, and hence are more unstable regimes. Carothers (2002) argues that hybrid regimes often have weak governments and institutions, poor economic policies and a corrupt judiciary. This stands in contrast to the fact that MNCs do prefer predictable investments conditions, which includes a strong rule of law, stable policies provided through veto players, and little internal conflict (Dunning 2001, 2008, Frey & Schneider 1985, Jakobsen 2010, 2012, Jarvis 2008). This thesis contributes to the existing literature by investigating a broad set of countries that often fall out of the democracy versus autocracy debate.

The relationship between FDI inflows and political regime type is not a straight-forward relationship to measure, because there are many factors that affect MNCs` investments decisions. This requires that the analysis done contains a wide set of variables that can control for other possible connections. Variables like economic growth, trade, internal conflicts, present FDI and natural resources are among those variables that are included, based on

former academic works done on the subject (Jensen 2003, 2006, 2008, Jakobsen 2006, Li & Resnick 2003, Li 2009). The empirical analysis is conducted with up to 154 different countries, and in the time-period 1980 to 2010. The number of countries and observations depends on the included variables and the conditions for each regression that are done. The dataset is based on a pooled time-series cross section (TSCS) design.

This thesis is divided into four main sections excluding this introduction and the conclusion. Chapter 2 provides the theoretical foundations on which the thesis is built. The chapter presents FDI, with a focus on political risk involved in doing investments in foreign markets and regimes. Further, it draws attention to the three political regime types used in the analysis, with a focus on their specific conditions that are relevant for MNCs. Chapter 3 presents the methodology, including variables, data, operational challenges and limitations. Chapter 4 presents the analysis, with different sub-sections that follow the path chosen based on the results. Chapter 5 discusses the results from the analysis, and presents possible explanations for the main findings, together with implications, limitations, and recommendations for further research. The last section of the thesis is the conclusion which sums up the important findings of the analysis.

The thesis sets out to explore the role of the hybrid regime type's relationship with FDI inflows (measured as a share of GDP), compared to the more commonly measured democratic and autocratic regimes types. The results provide a diverse picture of the regime categories, with autocracy scoring lowest when it comes to attracting MNCs, proving that hybrid regimes do attract higher levels of FDIGDP inflows than authoritarian regimes. The difference between hybrid and democratic regimes are more complex, with the region Africa turning the results upside down. When including the continent of Africa, hybrid regimes have on average 0.65 percentage point higher FDIGDP inflow than democratic regimes, all else being equal. When Africa is excluded from the analysis, democracies receive on average 0.5 percentage point higher FDIGDP inflow than hybrid regimes. This means that the analysis give a clear answer to the hybrid versus autocratic question, while the answer to hybrid versus democratic question is more complex because of the region of Africa. This is likely because of political instability, low economic growth, and natural resource dependence, which see low levels of FDI inflows, and hence creates results contrary to the rest of the world for Africa. Among the

possible explanations for this, is that a low level of GDP can make the percentage of FDI inflow higher compared to other continents. The findings in this thesis are in line with those who argue that democratic features attract MNCs, while it contributes with new knowledge to the field through findings that indicate that hybrid regimes do receive an unexpected high amount of FDI inflow.

## 2. Theory

This chapter is split up into three main sections. Firstly, an introduction to the fields of FDI and political risk are presented. Secondly follows a discussion of the three political regime types, their special features, and their influence on FDI inflow. Lastly follows a presentation of previous findings within the field of research that are relevant for this thesis.

### ***2.1. Foreign Direct Investment***

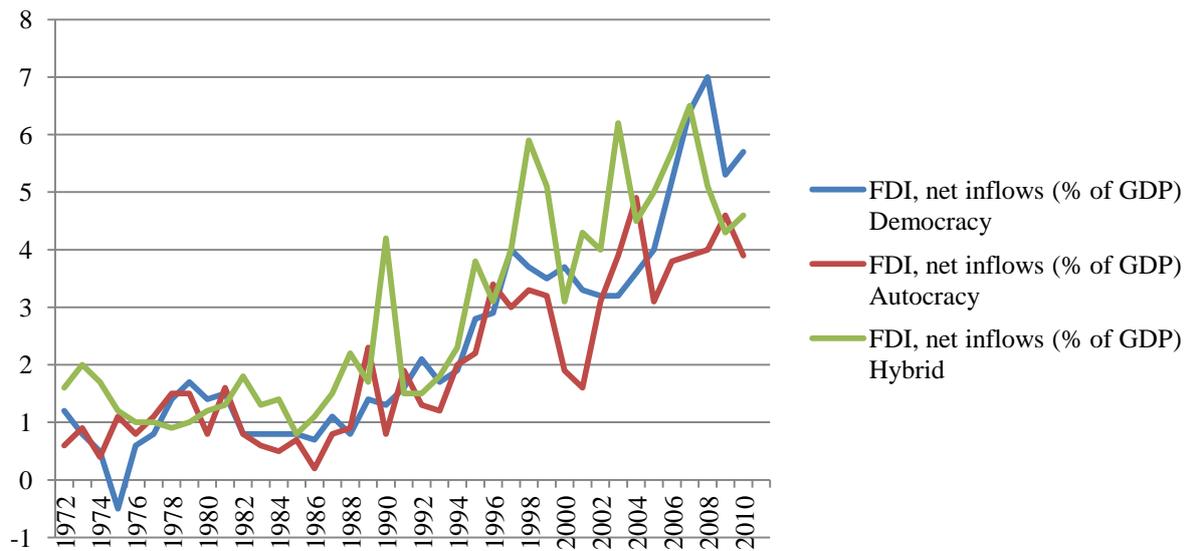
The purpose of this research is to investigate what political regime type that attracts most FDI inflow. It is therefore vital to discuss and define some of the key terms, like FDI and political risk. This section will do this, but it will also describe the mechanisms that make for investment across borders.

Foreign direct investment is a term used when a firm makes a direct investment in facilities to produce or sell a product in a foreign country. For purposes of operationalization, the general rule is that the firm needs a stake at minimum 10 percent for it to be seen as FDI<sup>1</sup>, and once the investment is made, the firm will be seen as a multinational enterprise. This can happen through two main forms. Greenfield investment is one of the two, and involves establishing a new operation in the host country. The other form is through mergers and acquisitions (M&A), where the MNC buys a share in a firm that is already established in the host country. This share can range from a minority stake at 10 percent, up to a full outright stake at 100 percent (Hill, 2011: 232). After the financial crisis starting in 2007, one has seen that greenfield investments have become more numerous than M&A. Especially developing and transitional economies have seen a rise in greenfield investments, with M&As decreasing in numbers (World Investment Report, 2011:35). One reason for this may be that there are fewer potential firms to target for an M&A in developing countries.

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<sup>1</sup> These are the statistical rules used by the International Monetary Fund (IMF).

**Figure 2.1: FDI/GDP inflows, by regime type.**



\*Own calculations based on FDI and GDP data from the World Bank, and democracy data from Polity IV. On this -10 to 10 scale, democracy is here defined 6 to 10, hybrid -5 to 5, and autocracy -6 to -10. OECD-countries are excluded. FDI is measured as percentage of GDP, so that each country is weighted equally.

The last 30 years have seen a huge rise in both the flow and stock of FDI in the global economy. Figure 2.1 shows that as the world economy grew, so did FDI inflows, with 2007 as a top high. One can get an indication of what is to come in the analysis, with the variable FDIGDP separated into the three regime categories. The democratic and autocratic lines are stable in their growth, while the hybrid category is somewhat more unstable. The reason for this might be that important countries fall in and out of the hybrid category, influencing their scores either way. The financial crisis that started in 2007 is also reflected in the graph, with a big drop in the following years. Companies turned their focus away from foreign investments when cuts became a necessity. The world economy is slowly gaining momentum, so is the inward flow of FDI, which in 2010 is back on a positive curve (Hill 2011).

### 2.1.1. Why do MNCs invest abroad?

Globalization has given rise to many thousand firms that trade across borders and which can be called multinational companies. The fact that firms do go abroad, likely enhances economic development. But what makes MNCs invest in other states and markets, especially when other options for internationalization, like licensing and exporting, are available? This is

an interesting point when one knows that FDI is both expensive and risky, when compared to the options mentioned above.

One way to look at this issue is to look at the weaknesses of the options to FDI, namely exporting and licensing. Firstly, firms that produce goods that have high transportation expenses are likely to look towards FDI. By illustration, instead of shipping products from Europe to Asia, a firm can establish a factory in that foreign market (Hill, 2011: 239). Secondly, many firms are vulnerable to trade barriers that governments impose on imported goods, which make the product more expensive in foreign markets. The last 30 years have seen many international trade agreements that have reduced these trade barriers, so goods and services can be traded across borders without extra costs (Oatley, 2010: 96).

The other alternative to FDI is licensing, which also has its drawbacks for some firms. Firstly, this becomes evident for firms which have valuable technological know-how that it needs to protect. Secondly, licensing does not give firms enough “tight control over manufacturing, marketing, and strategy in a foreign country that might be required to maximize its profitability” (Hill, 2011:241). Solving this issue is done through FDI, which gives the firms tight control of most aspects of its business in the foreign country. Thirdly, many firms have its capabilities when it comes to human resources. The product and lifeline of the business is based on highly competent personnel that handle management and marketing, which cannot be licensed to foreign countries, therefore they choose FDI (Jarvis 2008).

This section has highlighted the reason to why multinationals do invest in foreign markets, the next section will analyse what conditions they prefer in host countries. The focus will mainly be on factors related to regime types.

### **2.1.2. What do MNCs look for?**

Multinational corporations are complex organizations that have diverse set of conditions when they are considering investments abroad. Dunning’s ownership, location, internalization (OLI) framework is a set of three theories related to FDI, which analyse and explains why firms invest abroad (Dunning 2001, 2008). Of high relevance to this thesis, location-specific advantages are one part of this, and it takes the economic, political and social advantages of

countries into account when MNCs analyse where to invest. Countries do have endowments that might attract interest from abroad, be it a low-cost labour force or natural resources. They might also have specialized incentives aimed at attracting foreign firms, like tax havens or special legal protection (ibid). This thesis focuses on political regimes and FDI, and will therefore analyse what MNCs want from the host countries' political system.

The first factor that needs to be highlighted is also the most important one, *political stability*. This is a broad term that can be divided into many subgroups, such as regime stability or the absence of rapid policy change. Political instability and violence has a negative effect on FDI, because the investment climate will become poor (Busse 2003, 2004, Jensen 2003, 2006, 2008, Jakobsen 2006, 2012). If the political waters of a country change rapidly, foreign firms will find it hard to navigate and make long-term investments because one does not know how the situation will be in 1, 5 or 10 years. MNCs seek countries that can provide stability and predictability in the political sphere, so that they know that their investments are safe and can continue to be profitable. Change of status quo can be both positive and negative for MNCs, but in most cases they want conditions to stay the same, so it is easier to predict profitability (Bremmer 2005, Bunn & Mustafaoglu 1978, Jakobsen 2010, Jarvis 2008, Simon 1984). Political stability is a broad term that involves many actors, with a varying degree of influence on foreign firms. Firstly, regime stability is vital for the continuation of status quo. Countries that experience political instability that leads to regime change are challenging for MNCs because the situation is difficult to predict, and what the future brings is unknown. Secondly, political instability could lead to change in the executive branch, which in turn might bring about unexpected change in policies. Rapid change in policy might not be in favour of foreign firms, and potential losses can be big. Thirdly, the term political stability also deals with the security in society when it comes to violence. Regimes that do not have strong institutions that can handle violent acts from actors in the society can be regarded as unstable, and multinationals will avoid these societies if possible.

The second factor that is important for multinationals is the presence of a strong *rule of law*. Investing abroad naturally involves the entering into contracts with different actors. MNCs seek regimes that can provide protection of these contracts, so that they do not risk unfavourable breach of them. Firms need to be able to count on the fact that all parties will

abide by court rulings, and that the judicial system acts independently and follows the given law. Breach of contracts is highly costly for foreign firms, and the rule of law is an important protector of MNCs` rights in a host country. If a country has a weak educational system, this might very well affect the rule of law through poorly educated judges and bureaucrats. Officials who do not have the sufficient knowledge have a higher possibility of making weak and wrong decisions, which might have crucial effects on MNCs (Dunning 2001, 2008).

The third factor that MNCs needs to evaluate when they invest abroad is *government functioning* of the host country. This is a broad and complex term which covers both the quality of policies implemented by the government, and the independence and effectiveness of the civil service and other institutions. MNCs that invest abroad, seek host countries where the government implements FDI-friendly policies, and has a bureaucracy that acts independently from political pressure. This will create an investment-friendly market multinationals can operate in. If a regime has well-functioning policy implementation procedures, it demonstrates that FDI-friendly policies will be implemented correctly as well. An independent bureaucracy will then be able to put the policies into life in a predictable way, without interference by politicians or other actors. For the foreign firm this means that they can trust that policies implemented by politicians will not be changed because of corrupt officials. This is important when they plan their decisions and business tactics (Hill 2011). Well-functioning and transparent institutions are of utmost importance to multinationals, especially in the protection of property rights, which is the foundation the investment is based on. If property rights are violated, MNCs risk heavy losses (Bevan et.al. 2004, Jakobsen 2012). Once the FDI decision is made, the investment can be regarded as sunk into the host country, and is thus part of its national institutional landscape. This is where the obsolescing mechanism<sup>2</sup> comes into effect. Good institutions will hinder that the executive will threaten foreign firms and hold their investments as hostage in negotiations for better terms. The respect for contracts and stability of policy are vital for MNCs.

This section has gone through the most important political regime factors foreign firms evaluate when they invest abroad. The next section will discuss political risks related to FDI.

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<sup>2</sup> The obsolescing bargaining mechanism describes a part of the negotiation process between the host country and the foreign firm. The idea is that once the MNCs have made large investments, which are often non-removable (for example oil rigs, copper mines, and production plants), the host government can use this as a “hostage” in the renegotiation of contracts (Jakobsen 2006).

### **2.1.3. Political Risks**

Making investments in foreign countries is a complicated process with many aspects, and it is based on a risk/return analysis made by the firms. What is the potential profit? What types of risk are present? These are important questions MNCs have to ask when they are considering different locations for investment. The section above outlined what it is that makes firms want to invest abroad, the present section will look at political risks that might harm these investments. The section will start with a definition of the term, followed by a discussion of the different factors within it.

Lloyd (1974: 24) argues that; “The concept of risk implies uncertainty about the outcome of an event, which is a function of the interaction of variables affecting the event.” This gives us an impression of the basic concept of the word risk. And in our research, it is political risks that are of concern. The concept of political risk is a broad term which is used to describe many factors, and can be “defined as the impact of politics on markets” (Bremmer, 2005: 52). There are several authors who have definitions on the concept (Bremmer 2005; Jakobsen 2012, Jarvis 2008), and Howell provides this one:

...`political risk` refers to the possibility that political decisions or events in a country will affect the business climate in such a way that investors will lose money or not make as much money as they expected when the investment was made. (Howell 1994: 1)

Even if definitions vary, it is clear that the concept of political risk concerns businesses that want to make an investment abroad. Political factors do have the potential of changing the prospects for the profitability of that investment, and this scenario occurs frequently. Recent events in the Arab world are illustrative. The last two years have seen a blossoming of democratic expression in North Africa and the Middle East, called the “Arab spring”. Political instability, civil war and revolutions are not attractive for MNCs who want to protect their investments. Many firms risk losing their investments, and are therefore considering their presence in the area. Numbers for 2011 show a reduction of up to 20 percent in FDI in the Arab nations involved in the uprising (UNCTAD 2011: 43).

**Table 2.1: Political Risk**

<b>Sources</b>	<b>Effects</b>
<b>Direct host government risk</b>	- Nationalization, expropriation, breach of contract, import/export regulations, restrictions on remittances, environmental standards, inflation, and recession.
<b>Direct host society risk</b>	- Protests, strikes, riots, demonstrations, terrorist attacks, boycotts, and negative public opinion.
<b>Indirect host government risk</b>	- Civil war, revolution, guerrilla war, protests, riots, demonstrations, election of anti-FDI politicians, and pressure from groups to restrict foreign business.
<b>Indirect host society risk</b>	- Ethnic /religious conflicts, factional conflicts.

MNCs need to consider many aspects when they invest in foreign countries, especially important are political risk factors that might be a threat to their investments. Table 2.1 indicates four different sources to political risk that multinationals can encounter, it also highlights some of the possible effects created by these sources. I have separated between sources that directly affect MNCs, and those that have an indirect impact. Multinationals will always analyse the potential host country in relation to potential profit and possible risks that might harm their investment. This thesis makes a distinction between three regime types, and all of them are prone to political risk factors, but to a varying degree. Below follows some examples that show how all of these regime types do have potential risks for foreign investors.

**Table 2.2: Democratic regime: Bolivia**

<b>Source</b> →	<b>Actor</b> →	<b>Effect</b>
Shift in political ideology	New leftist government	Expropriation of MNC

The political risk chain exhibited in Table 2.2 has been the reality for many MNCs, and is a potential threat in some countries where radical political actors are new potential leaders. When the left-wing President in Bolivia, Evo Morales, gained power in his country in 2006, he started a nationalization campaign which saw many foreign firms like Brazilian Petrobras and British Petroleum lose their investments in the country. The nationalization of the country's petroleum resources was not unexpected, as the country had seen many riots and demonstrations in the years leading up to the election of Morales. It was dissatisfaction with

the unsocial policies of the government that lead to these riots and fights between the army and protestors, where many people lost their lives (Jakobsen, 2012: 9).

**Table 2.3: Autocratic regime: Uzbekistan**

Source➔	Actor ➔	Effect
Lack of veto players	Executive branch	Expropriation of MNC

The U.S. firm *Newmont Mining Company* is in 2007 forced out of the autocratic state of Uzbekistan after an unexpected change in tax regulations that gives them a bill of \$48 million (see Table 2.3). The Uzbek froze their assets in the country and forced a state-led takeover (James, 2007). This is a good example of how the lack of veto players in a political regime can lead to catastrophic effects for foreign firms. The Uzbek President holds almost unlimited power in the country, meaning that the political elite can in practice do whatever they want. In this case a new tax regulation was quickly enforced, giving some foreign firms huge problems. If the country had been blessed with functioning checks and balances, other actors might have been able to stop the tax proposal. Unlimited power to the executive branch and a lack of veto players are common in autocratic regimes (Jagers & Gurr 1995).

**Table 2.4: Hybrid regime: Nigeria**

Source➔	Actor ➔	Effect
Socio-political instability	Rebel/terrorist organization	Kidnapping of personnel

In November 2011, three employees belonging to the U.S. oil giant *Chevron* are kidnapped from a vessel outside the hybrid state of Nigeria. The attack is just one of many carried out in the last decade by local guerrilla groups that demand more in return from the oil industry (Vanguard, 2011, BBC 2006). The lack of political and social stability in a country can affect MNCs, and may, as in this case, have vital consequences. In countries where the state is weak and internal conflict severe, foreign firms are more likely to see their investments damaged. It is also a fact that countries prone to civil war are likely to be hybrid regimes (Gates et.al. 2006, Gurses et.al. 2010, Hegre et.al. 2001).

Table 2.2-2.4 gives three examples of a possible political risk chain, that in the end harm investments done by multinationals. It is a fact that all political regime types have potential risks present, but the literature indicates that there are higher levels of political risk in hybrid regimes. The main reason for this is their political instability (ibid). This can lead to a number of situations that will threaten investments, like regime change, policy change, civil war, terrorist attacks, and export/import regulations.

This section has discussed why firms choose to invest abroad, what investment conditions they seek in host countries, and what political risks they must be willing to face. The next section will present the three regime types that are categorized in this thesis, and discuss certain regime distinctions in relation to FDI.

## ***2.2. Political Regimes***

This paper divides political regimes into three main categories: democratic-, hybrid-, and authoritarian regimes. By doing this it will prove easier to compare the groups, and ultimately to see what regime type attracts more FDI. This section will look at these regime types, and their important features. After evaluating the existing literature, I have found four important conditions that can help describe these regime types, in relation to their importance to MNCs. These factors are presented in Table 2.5, and will be used when the three regime types are discussed. The subsections on each regime will start with a definition, followed by a discussion of the main features and the relation to attracting foreign investment.

**Table 2.5: Important features of Political Regimes**

	<b>Democratic Regimes</b>	<b>Hybrid Regimes</b>	<b>Autocratic Regimes</b>
<b>Rule of Law</b>	-Legal accountability and a judiciary that is fully independent from the government. -Protection of property rights.	-Some states have a sufficient rule of law, but many have autocratic features.	-No legal accountability. -The judiciary is corrupt and influenced by the executive. -Uncertain conditions for protection of property rights.
<b>Political participation rights and civil liberties</b>	-Full political participation, with no limits. -Freedom of speech.	-Most states have democratic features, while some limited civil rights.	-Both media and political participation is limited, and often nonexistent.
<b>Veto Players / Horizontal and Vertical accountability</b>	-Several veto players and horizontal/vertical accountability.	-Often several veto players, but they are not accountable.	-Few veto players, if any. Those that do exist are not accountable.
<b>Government Functioning</b>	-Bureaucratic integrity. -Local government accountability.	-Some states have democratic features, some have autocratic.	-Corrupt and ineffective bureaucracy.

### 2.2.1. Democratic

The democracy debate that has been going on among academics for decades, have seen a rapid change in the last 30 years. From being a concept to describe stable Western democracies, it has grown into a broad term with many subtypes. The third wave of democratization and the end of the Cold War saw many states adapt to democracy. Figure 4.1 clearly show that the number of democracies have increased, from about 20 in 1950, to just over 90 in 2010<sup>3</sup>. And one can clearly state that democracy became the leading political system after 1990.

Campbell (2008: 4) states, “There exists not only one theory, concept or model of democracy, but clearly a pluralism (or plurality) of different theories and models.” Since so many countries adopt the governmental system democracy, and each political regime is unique, one has seen a flourishing of adjectives to describe these democracies (Collier & Levitsky, 1997). The different terms ranges from “liberal democracy” to “defective democracy”, and makes for an empirical challenge when one is to measure a country’s regime type. After reviewing the literature, I will now discuss the most important factors in the democratic state in relation to FDI inflow.

<sup>3</sup> See: <http://www.systemicpeace.org/polity/global2.htm>

Firstly, fully democratic regimes are based on the *rule of law*, which is there to keep the society predictable for its citizens, hence also for multinational companies. The basic notion in democracies is that “all citizens are equal before the law, which is fairly and consistently applied to all by an independent judiciary, and the laws themselves are clear, publicly known, universal, stable, and non-retroactive” (Diamond & Morlino 2004: 7). Fully democratic states can provide a legal system that ensures equal treatment of all companies, be they domestic or foreign. This implies that the level of corruption is low, because members of the judiciary cannot be influence or bribed, and it will also secure the protection of property rights, which are among the most important factors for MNCs when investing abroad (Jakobsen 2012, Mengistu & Adhikary 2011, Perry 2000).

*A well-functioning property rights regime* also ensures that a nation`s resources are allocated more efficiently, and it curtails rent-seeking and corrupt behavior by private and state agents. This ultimately benefits long-term investment and growth. (Jakobsen 2012: 96, italics added)

The points made by Jakobsen (2012) favor that well functioning democracies will attract more inward FDI than other political regimes. One of the most important factors for attracting multinationals is the protection of property rights, and democratic institutions provide this. The link between protection of property rights and economic growth was made by North and Weingast (1989), which Olson (1991) argued would lead to more economic growth in democracies than in autocracies. The fact that autocrats by nature are exploitative makes them unable to be credible in the protection of property rights

...the only societies where individual rights to property and contract are confidently expected to last across generations are the securely democratic societies. In an autocracy, the autocrat will often have a short time horizon, and the absence of any independent power to assure an orderly legal succession means that there is always substantial uncertainty about what will happen when the current autocrat is gone. (Olson 1993: 572)

The essence in the definition given by Olson (1993) above is that democracies will be able to provide more stable investment conditions for MNCs. The problem with autocratic executives

and the rule of law is that one cannot trust that conditions and laws will be stable over a longer time horizon. MNCs often need to make long term plans, and unstable surroundings makes this more challenging. The authoritarian executive can, if he finds it beneficiary, change the rules of the game to the disadvantage of the foreign investor. This could in the worst case scenario mean expropriation from the market, and big financial losses. Olson (1993) also highlights that a dictator which is unsure about his position as the executive, will try everything he can to stay in power. This implies making shortsighted decisions that might affect MNCs and their conditions for investment.

Secondly, the democratic regime provides a system where full *political participation* is present, which formally means that all adult citizens have the chance “to influence the decision-making process: to vote, to organize, to assemble, to protest, and to lobby for their interests” (ibid: 10). These regimes give the citizens full freedom to participate and express their opinions through political parties, the free press, and other organizations. This is part of the civil rights the states provide for its citizens. It is also possible for firms to protect their investments through lobbying or other measures, which is important for MNCs. The media sees no limitations on their work from the government, and the free press operates as a watchdog towards those in power. All of these factors have been found to be significant for MNCs when they choose where to invest, meaning that political freedom and civil rights attracts FDI (Harms & Ursprung 2002, Blanton & Blanton 2006).

Thirdly, a condition that is provided by democracies is the high level of *accountability*, both horizontal and vertical, through a number of *veto players* (Tsebelis 1995). The main features of accountability are information, justification, and punishment/compensation (Diamond 2004), that all need to be in place for it to be a democratic regime. The citizens have the ability to punish the executives if they are not satisfied with their performance, either directly through elections, or indirectly through elected representatives in the parliament. But office holders also need to “answer for their conduct to and have it reviewed by other institutional actors that have the expertise and legal authority to control and sanction their behaviour” (ibid: 17). In democracies, one finds many veto players that can control the executive: the court system, the opposition in parliament, investigative committees of parliament, the central

bank, the ombudsman, and other bodies that can control and limit the power of those who govern.

The potential for policy change decreases with the number of veto players, the lack of congruence (dissimilarity of policy positions among veto players) and the cohesion (similarity of policy positions among the constituent units of each veto player) of these players. (Tsebelis, 1995: 289)

A fully democratic country will be seen as predictable when it comes to policy changes, which will attract foreign investors who seek stability (Henisz 2000, Jakobsen 2006, 2012, Jensen 2003, 2006, 2008). The contradictory part of that argument is that some economic policies might not be in favor of the foreign firm, and changing them would be hard because of the number of potential veto players blocking the proposal.

Lastly, democracies also tend to have a *well functioning government*, which includes a bureaucracy with integrity and accountability. One can trust that officials have the correct expertise, and that they are independent in their decision making, which creates stability for the society and foreign investors (Diamond & Morlino 2004). This implies that a political regime has a government that can effectively implement needed policies, there exists an independent bureaucracy to implement them, and transparency is present at all levels, so that decisions and actions can be controlled by other parts of the society. Mangistu & Adhikary (2011) find that a well-functioning government correlates positively with FDI inflow.

These four conditions highlight how the democratic regime stands in regards to its attractiveness for FDI. The same points will be used below when the autocratic regime is analysed in a similar way.

### **2.2.2. Autocratic**

On the opposite side of democracy on the political system continuum, one finds what are called authoritarian regimes or, more neutrally, autocracy, as some prefer. This has been a way of rule for decades, and “is a pejorative term for some very diverse kinds of political systems whose common properties are a lack of regularized political competition and concern

for political freedoms” (Marshall et.al. 2010: 15). This section will discuss the autocratic regime type in relation to the four factors presented in table X, which I argue are the most relevant aspects for MNCs.

...autocratic characteristics derive from “limited pluralism” as opposed to “almost unlimited pluralism” under a representative democracy. They may include government co-optation of civil leadership or legal limitation of pluralism, a single leader or small ruling clique, and weak political mobilization. Regardless of the methods rulers use to enhance their legitimacy, autocratic politics is biased in favour of narrow elite control over public policy. (Li & Resnick, 2003: 181)

Firstly, autocratic regimes lack a fully functioning *rule of law*, and are thus likely not to provide protection of property rights for MNCs. The legal system is often not predictable for its citizens, and the judiciary is often corrupt (Acemoglu 2008). The lack of integrity creates instability, and companies cannot be sure if laws will be followed. There are endless incidents around the world where foreign firms have experienced difficulties in host country court systems, and in some cases they have been (what one could call) robbed of their assets (Jakobsen 2012). These incidents seem to occur often in autocratic regimes where the executive has unlimited power, and influence over the judiciary. As was the case mentioned in Table 2.3, when the U.S. *Newmont Mining Company* was forced out of the autocratic state Uzbekistan in 2007. An unexpected tax regulation gave them a sudden \$48 million bill from the government, ending in their assets being frozen. The judiciary system was in the hands of the executive, and hence was of no help for the foreign company (James 2007).

Secondly, fully autocratic regimes *lack political participation rights* for their citizens. Oppositional parties are repressed or stopped through legal controls, which will hinder their participation (Jagers & Gurr 1995: 470-471). Fraud and corruption is so common that there need not be any correlation between what the voters prefer and the electoral results. In the most extreme cases (e.g. Egypt and Uzbekistan) the civic liberties are “violated so systematically that opposition parties, civic groups, and the media are not even minimally protected” (ibid: 8). As a consequence one often sees much of the opposition activities operating underground or in exile. This is evident when one looks to the case of Myanmar,

where the oppositional radio station “Democratic Voice of Burma” is broadcasted from the Norwegian capital Oslo, and is banned in the home country Myanmar.

Thirdly, the number of *veto players* and the level of *horizontal/vertical accountability* are low in authoritarian regimes. The citizens do not have the chance to punish the executive through elections if they are dissatisfied with its performance, making revolution the only possibility. The checks and balances in the state are not working effectively, because the executive holds all power. This means that they cannot control and correct the decisions made. The governmental institutions are in a way “puppets” in the executive’s power game. However, the fact that the executive does not have any potential enemies for the position in power makes the regime more stable. This status quo is best upheld through a determined repression of the opposition. Haggard (1990) points out that autocracy protects its political elite from pressure on the allocation of economic resources, and this will give the executive a possibility to favour economic policies that will enhance inward FDI.

The conventional wisdom is that multinationals prefer to invest in authoritarian regimes. Authoritarian leaders can provide multinational firms with better entry deal, because of the lack of popular pressure from below, and the repression of labour unions to drive down wages. This relationship leads to higher levels of FDI inflows to authoritarian countries. (Jensen 2003: 593)

This argument was also stressed by O’Donnell (1974) who says that the labour force in authoritarian regimes will be repressed to that extent that they will not demonstrate. This allows the executive to keep the wages low, which means low labour costs for multinationals.

Lastly, *government functioning* in authoritarian regimes is not accountable, and lacks integrity. The most vital sign is that state institutions are exploited by the executive and its supporters, which creates a big gap in the access to resources (Jagers & Gurr, 2012: 471-72). MNCs cannot always trust that the bureaucracy has the correct expertise when it comes to the implementation of certain policies, which might hamper efficiency. The lack of integrity and independency should also be of concern, because it opens up for corruption as a possibility (Diamond 2002). The lack of a transparent and efficient government is by some scholars found to be negatively correlated with FDI inflow (Mengistu & Adhakary 2011).

These are the features most autocratic regimes have in common, quite contradictory to the ones of the democratic regimes. Relating this to the needs of MNCs, it is clear that we expect that autocratic regimes will receive less FDI inflow than democratic regimes. But this section also outlined some arguments for a positive correlation between FDI inflow and autocracy. The next section will analyse these conditions in the context of hybrid regimes.

### **2.2.3. Hybrid**

The political regime sphere between democracies and autocracies has seen the creation of many subtypes of the two ideal types. The regimes in this “gray zone” fail to qualify as democracies or autocracies (Carothers 2002), and in this thesis these states will be gathered under the term hybrid regimes.

Hybrid regimes are not a new concept in political science, and it saw its roots in the 1960s and 1970s, with some authoritarian regimes letting the opposition participate in elections. Two of the regimes combining democratic and authoritarian elements were Singapore and Malaysia, both of which have kept this model ever since. And this is the very essence of the hybrid regimes we see in contemporary politics today, combining elements of democracy and autocracy. This has made labeling them very challenging, and there is a vast body of literature that has recognized the commonness of hybrid regimes (Diamond 2002, Zakaria 1997, Epstein et.al. 2006, Merkel & Croissant 2000, Levitsky & Way 2010, Schedler 2006, Ottaway 2003). In the table below, we see that scholars have tried to define different subtypes of democracy and autocracy, which this thesis places under the term hybrid regime.

**Table 2.6: Complexity of Hybrid regimes**

<b>Democracy</b>	<b>Autocracy</b>
-Semi-Consolidated Democracy (Freedom House)	-Competitive Authoritarianism (Levitsky & Way 2010)
-Electoral Democracy (Dimond 2002)	-Electoral Authoritarianism (Schedler 2006)
-Illiberal Democracy (Zakaria 1997)	-Semi-Authoritarianism (Ottaway 2003)
-Partial Democracy (Epstein et.al. 2006)	
-Defective Democracy (Merkel & Croissant 2000)	
-Exclusive Democracy (Merkel & Croissant 2000)	

Academics are here adding adjectives to democracy and autocracy, so to describe new and special forms of political regimes, which fall under the label of hybrid regimes. These regimes are most likely not “in transition” from one regime type to the other (Carothers 2002), but are in a “foggy zone” (Schedler 2002: 37). Charothers (2002: 9) labels this as a political “gray zone”, and emphasizes that most countries are likely to remain hybrid regimes for the foreseeable future.

Of the nearly 100 countries considered as transitional in recent years, only a relatively small number-probably fewer than 20-are clearly en route to becoming successful, well-functioning democracies or at least have made some democratic progress and still enjoy a positive dynamic of democratization. (Carothers, 2002: 9)

The category containing these countries is evidently not small in numbers, and these are not mainly states shifting from autocracy to democracy, as was the mainstream idea after the third wave of democratization and the breakup of the Soviet Union (Levitsky & Way 2010: 19). Hybrid regimes have some democratic features, including at least a minimum “political space for opposition parties and independent civil society, as well as regular elections and democratic constitutions” (ibid). But these states will always lack “at least one of the four aspects of a minimal democracy” (Morlino 2009: 282). It is impossible to label hybrid regimes with a common set of governmental features, the diversity is too big. The following section will show how these states have a mix of democratic and autocratic features.

Firstly, the *rule of law* in hybrid regimes is in some states well functioning and accountable, but in other states it is very weak. Many states will have an independent judiciary, while others are highly influenced by the executive. Abuse of the law by governmental officials is

common in many countries, making them comparable to autocracies (Merkel 2004). This is the case for the Russian Federation, which has seen many businessmen arrested and many foreign firms expelled from the country. Statistics show that one in six businessmen in Russia have been prosecuted for an alleged economic crime over the past ten years, most cases with no plaintiff and almost zero judgments for the defendant. This suggests that the government picks out their enemies, and puts them up for trial. Since the judiciary lacks independency and are viewed as highly corrupt, they will receive jail time, effectively putting them out of the battle for power (The Economist 2011b). These are stories that, to some extent, should keep MNCs away from the Russian market. Hence also showing how some hybrid regimes are prone to deep problems relating to the rule of law.

Secondly, *political participation rights* are often present, but in some states this only extends to the participation in elections. Many states suffer from a very low political interest among its citizens, which is created by the political elite's domination (Morlino 2009). This will in some cases bring about a growing dissatisfaction among certain groupings in the society, which can create demonstrations and violence.

Harshly authoritarian states and institutionally consistent democracies experience fewer civil wars than intermediate regimes, which possess inherent contradictions as a result of being neither democratic nor autocratic. Semi-democracies are partly open yet somewhat repressive, *a combination that invites protest, rebellion, and other forms of civil violence.* (Hegre, Ellingsen, Gates & Gleditsch, 2001: 33, italics added)

This observation is important when it comes to inward FDI, because it leads to the expectation that MNCs will avoid locations that have a high degree of domestic upheaval (Schneider & Frey 1985). The fact that hybrid regimes are partly open yet somewhat repressive, invites for the dissatisfied opposition or population to protest openly. This can go even further and result in a regime change, which will bring the policy conditions for multinationals under the risk of change (Gleditsch 2007: 6). This was, for example, the case in late 2008, when Guinean President Lansana Contè died, immediately sparking a military coup. The new executives started a nationalisation process in the natural resource industry, which saw many foreign firms lose their assets (Jakobsen 2010). One of them was the international mining group Rio Tinto, which had several mining concessions in the country.

After the military coup, they soon received a letter questioning the legitimacy of their deal with the government, and the new leaders demanded that Rio Tinto gave over its assets to them. The mining group did not give up, and after more internal conflict in the country, they manage to come to an agreement with the new democratic elected government in 2010 (Bloomberg 2009). Similar cases have occurred in other African countries, like the Democratic Republic of Congo (McClern 2012), and show how a rapid regime change may bring about difficulties for MNCs.

Thirdly, this diversity is also the case for the number of *veto players* and the *horizontal/vertical accountability*, where some have well-functioning checks and balances, while others do not (Ottaway 2003). Many hybrid regimes have recently been autocratic, meaning that they may still struggle with the traits of the past when it comes to checks and balances. The political system is not yet fully developed into a democratic regime, with veto players that can control the power.

Institutionally inconsistent political systems are not self-enforcing. Authority is not sufficiently diffuse to ensure that the democratic process is not subverted or challenged. Elites in such a system are tempted to garner more power for themselves and thereby compete with one another, creating an inherently unstable system. (Gates & Jones 2006: 895)

The fact that hybrid regimes are not self-enforcing indicates that they are more unstable than democracies and autocracies. The problem arises when states neither have a high degree of concentration of power, nor incentives for individuals to maintain a democratic system. Both of these traits are good sources for stability. Hegre et.al. (2001: 34) sums this up in a short sentence: “Semi-democracies are the least stable type of regime.”

Lastly, *government functioning* is something that is quite similar in most hybrid regimes; it is often weak in important areas. Corruption, self-interest, and ineffective officials give the government little integrity and accountability (Brownlee 2009). The state is often weak in its implementation of policies and this creates bad economic development.

Overall, politics is widely seen as a stale, corrupt, elite-dominated domain that delivers little good to the country and commands equally little respect. And the state remains persistently weak. *Economic policy is often poorly conceived and executed, and economic performance is frequently bad or even calamitous.* (Carothers 2002: 10-11, italics added)

The fact that many hybrid regimes struggle with weak government functioning, is an argument that indicates low FDI inflow. And as this section has highlighted, the concept of hybrid regimes is broad, and not easily defined. But for the purpose of this research thesis, it is necessary to gather these “gray zone” states within one group. The last section of the theory chapter will now follow, with a review of the empirical literature.

### **2.3. A review of the empirical literature**

The academic field researching the relationship between regime type and FDI inflow is relatively new, but in the last ten years there have been a substantial amount of work done. Most research have showed that democracies attract most FDI (Jensen 2003, Jakobsen & de Soysa 2006), but some academics report contradictory results (Li & Resnick 2003). This section has two tables, the first one presenting research that finds that democracy is the preferred regime type for MNCs, the second presents other findings on the topic.

**Table 2.7: Democracy enhances FDI inflows:**

<b>Authors</b>	<b>Main findings</b>
<b>Schneider &amp; Frey (1985)</b>	Analysing 80 developing countries, they find that <i>political instability significantly reduces FDI inflows.</i>
<b>Harms &amp; Ursprung (2002)</b>	Analysing 62 developing countries in the period 1989-1997, they find that <i>MNCs appear to be attracted by countries in which civil war and political freedom is respected.</i>
<b>Busse (2003, 2004)</b>	Analysing 69 developing countries in the period 1972-1999, he finds that investments by multinationals are significantly higher in democratic countries. <i>Democratic rights and liberties are important factors.</i>
<b>Jensen (2003, 2006, 2008)</b>	First as an article, later developed into a book, Jensen finds that democratic regimes attract as much as 70 percent more FDI than autocracies. <i>Executive constraints lead to policy stability and more favourable policies towards MNCs.</i>
<b>Busse &amp; Hefeker (2005)</b>	Analysing 83 developing countries in the period 1983-2003, they find that <i>government stability, the absence of conflict, and providing rule of law are the most significant determinants of FDI.</i>
<b>Blanton &amp; Blanton (2006)</b>	Examining all non-OECD countries in the period 1980-2003, they find that <i>human rights are a significant determinant for FDI inflows.</i>
<b>Jakobsen &amp; de Soysa (2006)</b>	Building on Li & Resnick (2003) research, they find robust evidence showing that democracy is preferred by MNCs. They also conclude that <i>leftist governments among democracies attract more FDI than rightist.</i>
<b>Jakobsen (2006, 2012)</b>	Finds that multinationals prefer democratic environments for their investments, and that <i>executive's constraints and property rights protection are important factors.</i>
<b>Choi (2009)</b>	Similar to Jakobsen & de Soysa (2006), he reproduces the study of Li & Resnick (2003) and shows how outliers produce an artificial result. He concludes that <i>democratic institutions attract more FDI.</i>
<b>Asiedu &amp; Lien (2010)</b>	Analysing 112 developing countries in the period 1982-2007, they find a positive and significant correlation between democracy and FDI inflow. <i>But only if the value of the share of minerals and oil in total export are less than a critical value.</i>
<b>Mengistu &amp; Adhikary (2011)</b>	Analysing 15 Asian economies in the period 1996-2007, they find that four components of good governance are significant and positive in attracting MNCs: <i>political stability, government effectiveness, rule of law, and control of corruption.</i>

It is evident that most academics who have researched the relationship between political regimes and FDI inflows have concluded that democracy is the preferred type. Some of the common conclusions one can draw from this is that democratic institutions contribute towards stability and protection for foreign investors. Other interesting findings are the significance of human rights (Blanton & Blanton 2006), rule of law, executive's constraints, and the impact of natural resources. Former research will be considered and included if relevant in this thesis's analysis. Some academics have drawn other conclusion, and some have researched fields that can be related to the one done in this thesis. Below follows a table with other findings.

**Table 2.8: Other important findings on FDI inflows:**

Authors	Main findings
<i>Resnick (2001)</i>	Analysing countries in transition towards democracy, he finds that that path has a negative effect on FDI inflows, and that <i>political instability and higher levels of democracy also deters FDI.</i>
<i>Li &amp; Resnick (2003)</i>	Analysing 53 countries in the period 1982-1995, find that higher levels of democracy reduce FDI inflows. <i>Constraints on foreign capital and host government are important factors.</i>
<i>Emmert &amp; Tuman (2004)</i>	Analysing U.S. firm's investments into Latin America, they found that the quest for <i>protection of property rights led firms to invest in stabile authoritarian regimes.</i>
<i>Brada, Kutan &amp; Yigit (2006)</i>	Find that FDI inflows to countries in economic transition exceed Western European countries when conflict and instability is removed. But in the case of the Balkan countries, they find that <i>conflict and instability reduces FDI inflow significantly.</i>
<i>Yang (2007)</i>	Analysing 134 developing countries in the period 1983-2002, he does not find evidence for the claim that democracies attract more FDI inflow. <i>Being a democracy does not help attract higher levels of FDI.</i>
<i>Li (2009)</i>	Analysing 63 developing countries in the period 1960-1990, he finds that the decisive factor for expropriation is the chief executives` political incentive and policy-making capacity. <i>Political constraints on the executive are vital for security against expropriation.</i>
<i>Albornoz, Galiani &amp; Heymann (2011)</i>	Through modelling a two-sector small open economy, they find that if investment are undertaken in <i>sectors that uses labour less intensively then democratic expropriations are more likely to take place.</i>
<i>Jakobsen &amp; Jakobsen (2011)</i>	Analysing 42 non-OECD countries in the period 1990-2005, they find that <i>economic nationalism and "rightist" economic preferences deter FDI inflows.</i>
<i>Okafor, Ujah, Elkassabgi &amp; Ajalie (2011)</i>	Analysing 48 Sub-Saharan African countries, they find that the more <i>efficient, transparent, and accountable a country's democracy is the less FDI inflows it receives.</i>
<i>Zheng (2011)</i>	Analysing 135 countries in the period 1980-2008, he finds that countries with too many or <i>too few veto players are less attractive for MNCs because of either high policy uncertainty or high policy rigidity.</i>

The works of Resnick (2001), Li & Resnick (2003), Tuman & Emmert (2004), Yang (2007), and Okafor (2011) share common ground in the sense that they cast doubt over the research presented in Table 2.7 that show a positive correlation between democracy and FDI inflow. Li (2009) finds that political constraints on the executive are vital for protection against expropriation, which opens up for veto players as a significant variable in this thesis. This is taken further by Zheng (2011) who argues that a U-shaped relationship is present between veto-players and FDI inflows. Albornoz et. al. (2011) argue that expropriation is more common in less labor intensive sectors, which implies that there might be a difference between countries and their endowments. These findings will be used to assist in directing this thesis's analysis.

The theory section has shown how academics differ in their arguments when it comes to FDI inflow, some also differ in their opinion on what political regime type attracts most MNCs. This thesis provides a new perspective on the subject because it investigates a third regime type: *hybrid regimes*. The knowledge gained from this analysis will possibly make it easier to state what mechanisms in a political regime are decisive for the investment decisions of foreign firms. By investigating a regime type that can be regarded as a grey zone between democracy and autocracy, I shed light on an important group of countries that has been neglected in former studies. By analyzing these former studies, I have come up with two hypotheses:

*Hypothesis 1:* Democratic regimes attract more FDIGDP than hybrid regimes.

*Hypothesis 2:* Autocratic regimes attract more FDIGDP than hybrid regimes.

With the presentation of the two hypotheses, the thesis now turns its focus over on the methodology used in the research.

### 3. Methodology

Like many others, this thesis employs time-series, cross-section (TSCS) data over the period 1980-2010. Not all variables have this time span, but the dependent- (FDIGDP) and the most important independent variable (POLITY2) do. The different variables are described more thoroughly below. TSCS data are commonly used in political science and other related disciplines, and are in this research characterized as repeated observations (years) on the same fixed political units (countries). As the data collection is getting bigger every year, this has become a popular way of doing research, because it gives the possibility to model time and space, and to generalize across the two. Below follows a discussion on TSCS pros and cons related to this research.

Firstly, the number of units gets very high compared to other methods, which gives a better foundation to draw conclusions. The dependent variable FDIGDP has 4897 observations in this analysis. This allows for testing the impact of a large number of predictors on the level and change in the dependent variable within the framework of a multivariate analysis (Beck, 2001, Beck & Katz 1995). Secondly, this research design can rely upon higher variability of data compared to the simple cross-section design. In pooled models like this one can include more variables. Thirdly, it gives the possibility to capture not only the variation of what emerges through time and space, but also the combination of these two simultaneously. This means, that instead of testing FDIGDP in one country and many years, or FDIGDP for all countries in one year, this design can capture FDIGDP for all countries in all years (Beck, 2001).

The main problem with this choice of research design is that “there is no panacea” (Beck & Katz, 2004: 2), or in other words, there is no simple TSCS command in STATA. This means that one has to make many hard thought decisions while doing the analysis. Below follows some of these challenges. Firstly, observations tend not to be independent from each other, which is one of the main rules for OLS testing. This is evident in this research because FDIGDP in a country in one year is affected by FDIGDP in the same country, the year before. FDI inflow to China in 2000 will be affected by and are dependent on FDI inflow into China in 1999. This, however, is resolved in an acceptable way by including the variable

FDISTOCK, which measures the present accumulated FDI in a country. And one therefore gets a variable that covers the potential serial-correlation. Secondly, heteroskedasticity can be a problem in TSCS data designs. This happens if nations vary so that the error variance varies from nation to nation. But this research has substantially more  $n$  (countries) than  $t$  (years), so the potential solutions for this problem will only create bigger ones, for example higher risk of multicollinearity and of underestimating the effects of interesting variables. One must therefore look at the fact that countries differ as an explanatory status, without a theoretical justification. We can also conclude that the  $t$  is large enough to do serious averaging over time and make econometric issues disappear (Beck & Katz, 2004: 3). The only big exclusion of countries that is done in all analyses in this thesis is the removal of OECD countries. This is because these countries have substantially more FDI inflow, and they would therefore make the results confusing. This action is in line with most academics within the FDI inflow/political regime debate. Thirdly, some variables may not have missing data for certain  $t$  (years). This is fixed with linear interpolation of these variables, meaning that they get somewhat artificial but still reasonable scores for those missing years, based on the average of the year before and after. This is a debated way of transforming variables, and it is important to notice which variables that are linearly interpolated. This is highlighted in the description of the variables below.

This section has discussed pros and cons with the chosen research design, and how these are handled in the thesis. Below follows a description of the variables included in the analysis.

### **3.2. Variables**

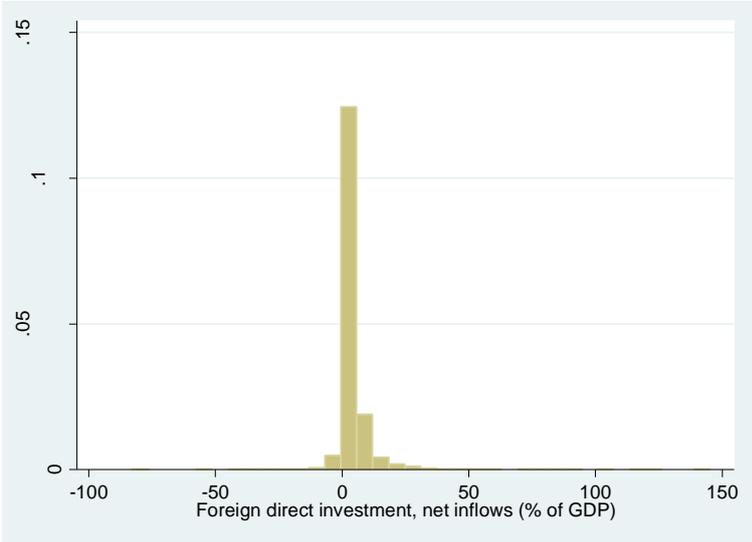
This part will go through the different variables used in the analysis, divided into three sections: dependent variable, independent variables, and control variables.

#### **Dependent Variable**

*FDIGDP*. The dependent variable in this thesis is inflow of foreign direct investment, in percentage of gross domestic production (FDI/GDP); this is in line with other academics (Asiedu & Lien 2004, Bütthe & Milner 2005, Choi & Sami 2008, Jensen 2003, Okafor et.al.

2011). The data is collected from the World Bank Development Indicators<sup>4</sup>, and runs from 1971 to 2010. It is the sum of reinvestment of earnings, equity capital, short-term capital, and other long-term capital as shown in the balance of payments. Other academics have used FDI in dollar amounts (Jakobsen 2006, Jakobsen & de Soysa 2006, Li & Resnick 2003) and FDI inflow per capita (Busse 2004, Harms & Ursprung 2002), but dividing FDI by GDP standardizes each countries varying economic size, and should therefore be more suitable. Using this measurement drastically reduces the influence of outliers, which will be higher with FDI in dollars (Choi 2009: 154). It is also the FDI measure that is closest to having a normal distribution, as shown in Figure 3.1.

**Figure 3.1: The distribution of FDIGDP**



**Independent Variables**

The thesis is set to analyse the relationship between FDI inflow and regime type, and based on the theory section, some main independent variables are chosen. These complement each other, which mean that the conclusion will be more robust. Below follows a description of the independent variables included in the analysis.

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<sup>4</sup> The data are downloaded from: [http //data.worldbank.org/](http://data.worldbank.org/).

*POLITY2*. To measure the level of regime type, this thesis uses the Polity IV dataset<sup>5</sup> (1961-2010). This variable measures the level of democracy, from the score -10 being a fully authoritarian regime, and 10 being a fully democratic regime. The thesis also uses dummy variables for each of the three political regime categories, and the recommendations from the Polity IV team are followed. The coding scheme for the dummy variables is: -10 to -6 for authoritarian regimes (Autocracy), -5 to 5 for hybrid regimes (Hybrid), and 6 to 10 for democratic regimes (Democracy). While others have used the threshold -7 to 7 for what they call an incoherent regime type (Yang 2007), this thesis argues that the best way to categorize these regime types is to follow the recommendations from Polity IV. Based on former research (Jensen 2003, 2008, Busse & Hefeker 2005, Busse 2003, 2004, Etten 2008, Schneider & Frey 1985, Feng 2001, Jakobsen & de Soysa 2006, Jakobsen 2012), it is expected that this variable will correlate positively with FDI/GDP inflow, which means that democratic regimes attract most foreign investors.

*Freedom House*. To complement the measure for political regime type *POLITY2*, this thesis includes the democracy index provided by Freedom House<sup>6</sup>, which runs from 1972 to 2010. The variable includes both political and civil rights, and are re-scaled so as to range from 1-13 (1= autocracy, 13= democracy). Checking for this variable makes the analysis more robust.

*VANHANEN*. To further contribute to the robustness of the political regime analysis, this thesis uses Vanhanen Democracy Index<sup>7</sup> in a sensitivity analysis. The data covers the years between 1980 and 2009, and objectively measures democracy based on electoral data. The variable measures the narrowness of success for the victorious party in an election for the executive branch, and is then interacted with the percentage of the inhabitants that participate in the election, so that the level of democracy is affected by any of the two indicators.

*WAR25*. To most precisely measure conflict within a country, this thesis uses *WAR25*. This is war or conflict with at least 25 battle-related deaths in a given year, and runs from 1962 to 2008. The variable is provided by the World Bank Development Indicators<sup>8</sup>. Li and Resnick

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<sup>5</sup> The data are downloaded from: [www.systemicpeace.org/polity/polity4.htm/](http://www.systemicpeace.org/polity/polity4.htm/).

<sup>6</sup> The data are downloaded from: [www.freedomhouse.org/](http://www.freedomhouse.org/).

<sup>7</sup> The data are downloaded from: <http://www.nsd.uib.no/macrodatabguide/set.html?id=34&sub=1>.

<sup>8</sup> The data are downloaded from <http://data.worldbank.org/>.

(2003) uses a variable to measure political instability with an event count of riots, strikes, revolutions, and coups into one index. Jakobsen & de Soysa (2006) argue that this index was too fragile and imprecise, and that WAR25 is a more appropriate measure to investor-relevant political instability and conflict. More than 25 battle-related deaths indicate that the government is not able to maintain sufficient law and order, and that the protection of property rights is at risk. And the host country will therefore not be attractive for MNCs. It is expected that WAR25 correlates negatively with FDI/GDP.

*IPEFREE*. In the sensitivity tests, this thesis uses a measure of economic freedom to analyse some of the components within a political regime, in relation to FDI/GDP inflows. Economic freedom measures the level of personal choice, voluntary exchange coordinated by markets, freedom to enter and compete in markets, and the protection of property rights. The variable is provided by the Fraser Institute<sup>9</sup>, and runs with a five year interval from 1970 to 2000, and then each year to 2010. The variable is interpolated, so it has values each year from 1970 to 2010. It is expected that more economic freedom will correlate positively with FDI/GDP inflow.

### **Control Variables**

Together with the independent variables, this thesis includes a set of control variables. It is important to include variables that can reflect and control for host-country potential. The below will describe the different control variables included in the analysis.

*GDPPC*. GDP per capita (logged to reduce skewness) is gross domestic product divided by midyear population, and it is an indication of the country's economic development. Some foreign firms are attracted towards markets with a wealthy consumer group, because they will be able to buy products. This might also mean that local labour cost are expensive, which might keep some firms away. But in general it is expected that GDPPC correlates positively with FDI/GDP inflow. The data are collected from the World Bank's *World Development Indicators*<sup>10</sup>, and runs from 1961 to 2010.

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<sup>9</sup> The data are downloaded from <http://www.freetheworld.com/>.

<sup>10</sup> The data are downloaded from <http://data.worldbank.org/>.

*GROWTH*. Economic growth and prosperity is often said to correlate positively with inflows of FDI (Schneider & Frey 1985). Foreign firms seek fast-growing markets, where there is an unused potential for big profit. This thesis measures this as the annual percentage growth rate of GDP per capita based on constant local currency. The data are collected from the World Bank's *World Development Indicators*<sup>11</sup>, and runs from 1961 to 2010. It is expected that *GROWTH* will correlate positively with FDI/GDP.

*TRADE*. Trade (logged) is a measure of the total sum of exports and imports of goods and services, in percentage of gross domestic product. Countries that are more open to trade, with low barriers for exports and imports, are attractive for MNCs (Harms & Ursprung 2002). The data are collected from the World Bank's *World Development Indicators*<sup>12</sup>, and runs from 1960 to 2010. It is expected that *TRADE* will correlate positively with FDI/GDP inflow.

*FDISTOCK*. Dunning (2008: 94) describes how externalities affect the MNC's decision on where to invest; one of these can be the presence of other foreign firms in the host country. Already present FDI might create a form of stickiness, and are therefore included in the models. *FDISTOCK* reflects the presence of other firms, and can also reflect the host country potential. The data are collected from *The United Nations Conference on Trade and Development*<sup>13</sup> database, and runs from 1980 to 2010. It is expected that *FDISTOCK* will correlate positively with FDI/GDP inflow.

*MINING*. The first natural resource proxy that is included is ores and metals exports, measured as percentage of merchandise exports. The variable includes what are known as SITC section 27, 28 and 68, and runs from 1962 to 2009. Data is provided by the *World Bank Development Indicators*<sup>14</sup>. Based on former research (Harms & Ursprung 2002), it is expected that *MINING* will correlate positively with FDI/GDP inflow.

*DOILRES*. The analysis also includes a dummy variable of a country's proved crude oil reserves. The variable is based on information from the *U.S. Energy and Information*

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<sup>11</sup> The data are downloaded from: <http://data.worldbank.org/>.

<sup>12</sup> The data are downloaded from: <http://data.worldbank.org/>.

<sup>13</sup> The data are downloaded from: <http://www.unctad.org>.

<sup>14</sup> The data are downloaded from: <http://data.worldbank.org/>.

*Administration*<sup>15</sup> (EIA), and it has valid numbers from 1980 to 2010. The dummy is coded 1 if a country's oil reserves > 2 billion barrels, and 0 if it is less. This gives a variable that can investigate if the big oil states can have an effect on the analysis. Based on former research (Harms & Ursprung 2002), it is expected that DOILRES will correlate positively with FDI/GDP inflow.

### **3.3. Hypothesis**

The theory section has given a broad foundation upon doing the analysis, and many hypotheses can be drawn from it. But for the purpose of this study, two hypotheses has been chosen:

*Hypotheses 1:* Democratic regimes attract more FDIGDP than hybrid regimes.

*Hypotheses 2:* Autocratic regimes attract more FDIGDP than hybrid regimes.

These two expectations are based on former research which has yielded contradictory findings on democracies and autocracies, but maybe more important is the theory on hybrid regimes which draws a picture of weak states with poor economic performance. Together with highly politically unstable countries, this leads to the expectation that hybrid regimes receive less FDIGDP inflow than democratic and autocratic regimes

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<sup>15</sup> The data are downloaded from : <http://www.eia.gov/>.

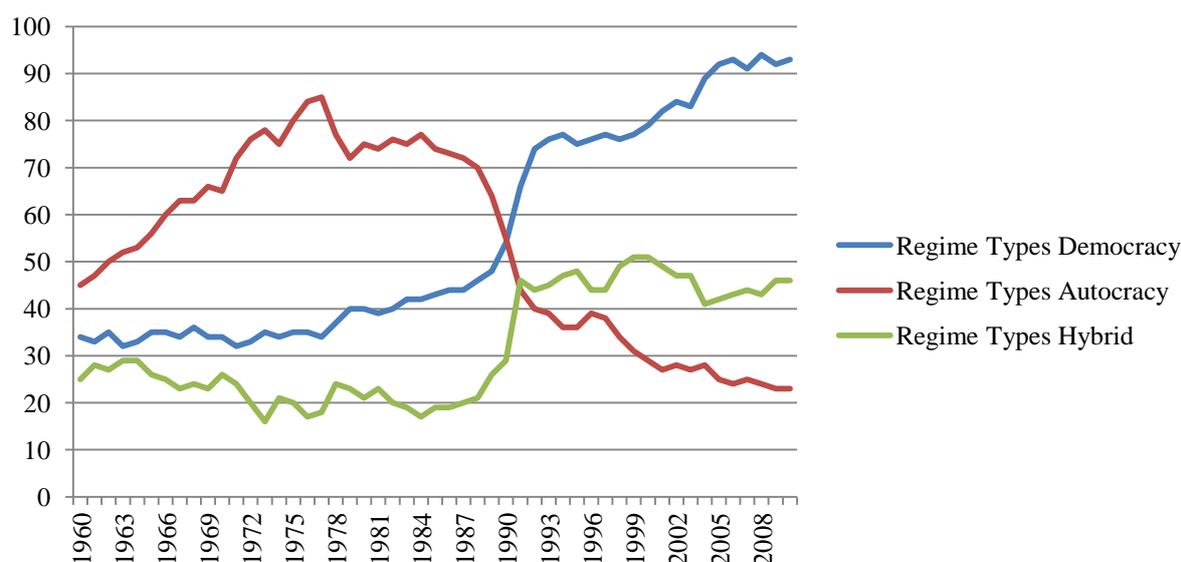
## 4. Results

This section will present the empirical analysis done for this thesis, and is divided into three subsections. Firstly, there will be tests for the correlation between FDIGDP and political regime type, with a set of control variables. To strengthen the analysis, a set of sensitivity tests are presented towards the end. Secondly follows a section that tests for regional differences. This is done so that one can get a more detailed picture of the main results. Thirdly, I perform a test on natural resources and their effects on the dependent variable.

### ***4.1. The political regime effect***

The thesis sets out to measure the effect of political regime type on FDI inflows, with a focus on what is called hybrid regimes. These are, as mentioned above, regimes that find themselves in between autocracies and democracies, and have by many been characterized as countries in transition (Carothers 2002). By looking at Figure 4.1 below, one can see that “the end of a transition paradigm” Carothers describes is evident when it comes to the characterization done in this thesis. The hybrid category moves steadily between 20 and 30 from 1960 to the end of the Cold War in 1989, which marks the big shift in political regime types in the world. Hybrid regimes then increases up to near 50. It then continues a relative stable path between 40 and 50. Contrary to what one might have expected, it seems that hybrid regimes are quite stable, which would be a positive signal for foreign investors who flee from politically unstable states. Democracies also follow a quite stable path before the end of the 1980s, when they nearly double within five years. This is the effect of the third wave of democratization and the creation of new states following the collapse of the Soviet Union. From the beginning of the 1990s, democracies have seen a steady increase, and are now at over 90. Autocracies have seen an opposite path compared to the other two, with its peak in the mid 1970s. A sharp increase from 1960 can be explained by the massive decolonization that took place after World War II. The end of the Cold War is reflected in the massive decrease of autocracies, which have continued to fall in numbers ever since, down to just over 20 in 2010.

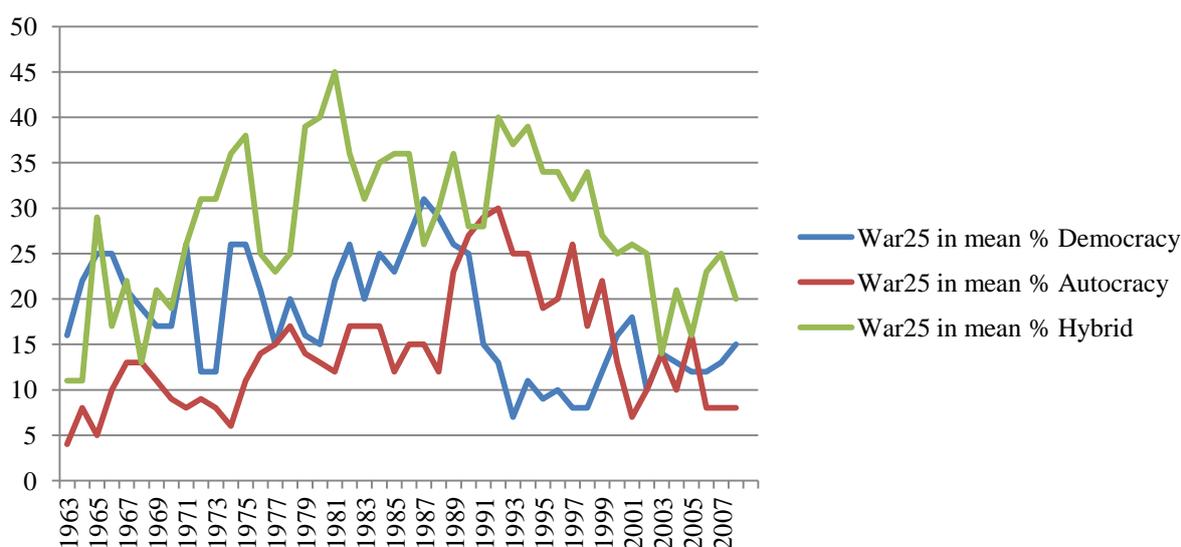
**Figure 4.1: Number of regime types 1960-2010**



\*Own calculations based on democracy data from Polity IV. On this -10 to 10 scale, democracy is here defined 6 to 10, hybrid -5 to 5, and autocracy -6 to -10. OECD-countries are included.

Figure 4.1 indicates that hybrid regimes are quite stable within its category, with few countries moving to democracies or autocracies. Figure 4.2 below shows us a different scenario, which might seem contradictory to the one above. It shows the percentage of countries within a political regime category with more than 25 conflict-related deaths within one year. This is one of the independent variables that is taken into the analysis to measure political stability, through the idea that more than 25 deaths represent an unstable internal situation. Here one can see that the hybrid regime category contains more states that are involved in internal conflict. The peak year 1980 saw 45 percent of all hybrid regimes having more than 25 conflict-related deaths in a single year. Comparing it to around 15 percent in autocracies and democracies, it is evident that hybrid regimes can be regarded as states with internal issues. This leads us to expect that investors might be skeptical to investments in these unstable regimes. A further observation is that every regime category has seen a substantial reduction in deaths from 1990 until 2010, which can be used as one (of many) explanation for the massive increase in world FDI inflows. One can say that the massive general decrease in conflicts, have resulted in more stable regimes, which attracts foreign investors.

**Figure 4.2: Percentage of countries with more than 25 conflict related deaths**



\*Own calculations based on battle related deaths data from the World Bank, and democracy data from Polity IV. On this -10 to 10 scale, democracy is here defined 6 to 10, hybrid -5 to 5, and autocracy -6 to -10. OECD-countries are excluded.

A glance at these two figures leads us over to the first set of models, which is set up with different political regime variables, and a set of control variables. In Model 1, POLITY2 is positive and significant, indicating that the more democratic the regime type, the higher FDIGDP the country will receive. Adding 1 point to the POLITY2 score will increase a country's FDIGDP inflow with 0.035 percentage points, all else being equal. By way of illustration, one can say that a fully democratic state will receive 0.7% more FDIGDP than a fully autocratic regime. The numbers might seem low, but compared to an average of 3.265% FDIGDP for all observations, it is substantial. This result is in line with the expectations. The control variables show a positive relationship with the dependent variable, with only WAR25 not being significant. Results on both Growth and Trade are in line with former scholars who argue that they enhance FDIGDP inflows. FDISTOCK is significant and positive. This indicates that the possible correlation between years have been checked for, the results show that FDI already present in a country do have a significant effect on FDIGDP inflows. This is in line with the expectations. It is evident that when a firm has invested in a country, it is likely to uphold its investments or enhance it in the following years. Through the clustering argument (Dunning, 2008), one can also reckon that MNCs will consider countries where other foreign companies are substantially present in a positive manner. Because it shows that doing investments in that country is reliable.

**Table 4.1: Determinants of FDIGDP in developing countries**

	Model 1	Model 2	Model 3	Model 4
<b>POLITY2</b>	.0352** ( 2.42)			
<b>Freedom House</b>		.155*** (6.08)		
<b>Hybrid versus Autocracy</b>			1.514*** (5.27)	
<b>Hybrid versus Democracy</b>				.669** (2.53)
<b>WAR25</b>	.408 ( 1.52)	.319 (1.23)	.796** (2.13)	.034 (0.10)
<b>GROWTH</b>	.193*** ( 11.85)	.111** (7.68)	.207*** (9.92)	.257*** (11.50)
<b>TRADE</b>	3.287*** (17.80)	3.362*** ( 19.64)	3.46*** (13.18)	3.566*** (14.59)
<b>FDI STOCK</b>	9.18e-06*** ( 3.31)	.0000107*** (4.01)	7.17e-06* (1.90)	9.17e-06** (2.47)
<b>CONSTANT</b>	-11.304*** ( -14.17)	-12.446*** (-16.71)	-12.905*** (-11.47)	-12.422*** (-11.72)
<b>Countries</b>	137	154	114	115
<b>Observations</b>	3210	3642	1995	2205
<b>R2</b>	0.149	0.149	0.158	0.1660

Source: Own calculations, based on the sources described in the text. Time period: 1980-2010.

T-statistics in parentheses.

\*, Significant on the 10% level.

\*\*, Significant on the 5% level.

\*\*\*, Significant on the 1% level

Model 2 is the same regression, the only difference being that Freedom House is the political regime measurement. The results are similar to those of Model 1, with Freedom House showing a strong positive and significant effect on FDIGDP inflow. Here, a 1-point increase on the 1-13 scale increases FDIGDP with 0.155 percentage points, all else being equal. One can also point out that the number of observations rises from 3210 to 3642 when the political regime proxy is changed to Freedom House. The control variables all show the expected results. Model 3 compares autocratic and hybrid regimes, with the same set of control variables as those above. This is done by measuring the dummy variable for hybrid regimes, and excluding democracies, leaving only autocracies as the comparable category. The result shows that hybrid regimes receive higher FDIGDP inflows than autocracies - 1.5 percentage points more on average, all else being equal. Because there have not been any former research comparing these categories, one could only make assumptions on what the result would be. According to the theory of political instability, one could expect that hybrid regimes would receive less. WAR25 is only significant in model 3 of this table, and it has a positive

correlation, which implies that having more than 25 conflict-related deaths actually increases FDIGDP. This indicates that foreign firms prefer investing in countries with internal conflict, which goes against the theory and expectations. This result can have several explanations. Firstly, it might be that MNCs actually do not mind small conflicts within the host country. One often sees in larger countries that internal fighting is located in certain areas and it might be that it does not pose a threat to foreign firms; this is in line with Berman's (2000) findings. For example, the hybrid regime Russia has seen internal conflicts in some areas, like the region Chechnya. I would argue that foreign companies that want to invest in Russia are not extremely concerned with that situation, because it most likely will not harm the foreign company. Secondly, it could be that some of the other control variables remove or reverse the effect of WAR25, because they effectively measure some of the same conditions. Removing TRADE from the regression turns the WAR25 coefficient negative and insignificant, this is because countries with civil war have economies and trade that functions on a lower level than others. Running a correlation analysis on FDIGDP and War25 gives us -0.049, indicating that when one does not control for other effects, internal conflicts like civil war have a negative effect on FDIGDP inflows. Thirdly, the dependent variable might mix up WAR25 through its control on economic size (FDIGDP). Because war-torn countries tend to have weak economies, the relative size of FDI can be bigger. While in stable countries, the economy (GDP) is stronger and therefore the FDI in percent of GDP are smaller. This explanation is controlled for by changing the dependent variable to lnFDI, which duly changes the coefficient to negative (see Table 4.2). Model 4 compares hybrid and democratic regimes, done by the same method used in model 3. Here one can see that the coefficient is positive, which indicates that hybrid regimes attract *more* FDIGDP inflows than democratic regimes. This result is against the predictions, which expected that democracies received most. Hybrid regimes have 0.66 percentage point higher FDIGDP inflow than democratic regimes, all else being equal, which is an interesting result. This will be further analyzed in the next sections.

#### **4.1.1. Sensitivity analysis**

To check for the robustness of the dependent variable, two alternative FDI measurements are included in Table 4.2. FDIGDP is the only one close to a normal distribution; lnFDI and lnFDIPC are therefore logged to reduce skewness. Models 5-8 have all significant political regime proxies, indicating that the results are in line with the rest of the analysis, and with the

literature. Because  $\ln\text{FDI}$  and  $\ln\text{FDIPC}$  do not control for economic size, the variable  $\text{GDPPC}$  is included. It is worth mentioning that the  $R^2$  is strongest in model 8. It is interesting to see that Hybrid regime receive more FDI inflow than Autocracy, while it receives less than Democracy. The results are contradictory to the findings in Table 4.1, but more in line with the theoretical expectations. I also run a set of regressions that are not included in any table. The first one includes a lagged dependent variable ( $\text{L.FDIGDP}$ ), which we in the main analysis covered for by using  $\text{FDISTOCK}$ . The result is in line with rest of the analysis, with a  $\text{POLITY2}$  coefficient at 0.036, significant on the 1 percent level. Further I run a regression with  $\text{VANHANEN}$  (coefficient at 0.057, significant on the 5 percent level), so to further strengthen the robustness of the political regime analysis. The results are in line with both  $\text{POLITY2}$  and Freedom House, showing that democratic regimes receive higher levels of FDI inflow than autocratic regimes. The same is done with the slightly different measure  $\text{IPEFREE}$  (coefficient at 1.173, significant on the 1 percent level), which measures economic freedom. One of its components, protection of protection rights, is of particular interest for this thesis. The results are significant, proving that more economic freedom attracts foreign investors. Overviews of the correlation between these variables are found in the appendix, Table 8.2.

**Table 4.2: Determinants of two alternative FDI measurements.**

	<b>Model 5: lnFDI</b>	<b>Model 6: lnFDI</b>	<b>Model 7: lnFDIPC</b>	<b>Model 8: lnFDIPC</b>
<b>Hybrid versus Autocracy</b>	1.162*** (3.65)		1.015*** (3.65)	
<b>Hybrid versus Democracy</b>		-.737*** (-3.44)		-.621*** (-3.36)
<b>WAR25</b>	.118 (0.29)	-.203 (-0.8)	-.069 (-0.2)	-.744 (-3.41)
<b>GROWTH</b>	.192*** (6.53)	.184*** (8.45)	.014*** (5.46)	.143*** (7.65)
<b>TRADE</b>	.794** (2.48)	.204 (1.03)	1.651*** (5.92)	1.16*** (6.75)
<b>FDISTOCK</b>	.00002*** (6.88)	.00002*** (8.11)	.00001*** (3.88)	.00001*** (4.98)
<b>DOILRES</b>	1.294*** (3.28)	.816*** (2.75)	.214 (0.62)	-.389 (-1.52)
<b>MINING</b>	.002 (0.33)	.005 (0.89)	.009 (1.29)	.008 (1.5)
<b>GDPPC</b>	.111 (0.74)	.589*** (6.15)	.48*** (3.63)	.875*** (10.60)
<b>Constant</b>	11.603*** (9.35)	12.933*** (13.92)	-10.110*** (-9.34)	-8.781*** (-10.96)
<b>Countries</b>	98	106	98	106
<b>Observations</b>	1171	1649	1171	1649
<b>R2</b>	0.135	0.171	0.155	0.249

Source: Own calculations, based on the sources described in the text. Time period: 1980-2010

T-statistics in parentheses.

\*, Significant on the 10% level.

\*\*, Significant on the 5% level.

\*\*\*, Significant on the 1% level

Section 4.1 has introduced the first models of regressions, which showed that regime type is positively correlated with FDIGDP inflows. The most interesting result found was that hybrid regimes received more FDIGDP inflow than both autocratic and democratic regimes. This was not as expected, and the analysis below will help clarify if these findings are valid, and what might cause this causation.

## **4.2. Regional variations**

The results in section 4.1 gave an interesting foundation for further analysis, especially the one indicating that hybrid regimes receives more FDIGDP inflow than democracies in developing countries. This section will analyse the possible effects of regions.

Table 4.3 presents regressions where the regions Africa and Asia & Oceania are separated and measured individually. These are the two continents that have a substantial amount of hybrid regimes. Latin America does have some cases of hybrid regimes, but not enough to get a satisfying variation. The variables are the same as in the first four models. Models 9 and 10 present the results for Africa and Asia & Oceania with POLITY2 as the political regime proxy. The coefficient for POLITY2 is only significant in Asia & Oceania, where it has a positive effect meaning the more democratic the state, the more FDIGDP inflow it has. WAR25 is only significant in Africa, with a strong positive coefficient. This result can be put in relation to the one in model 3, because it indicates that there might be high investments in war-torn countries in Africa. The other explanations discussed in model 3 also apply here, but it is interesting that the results are so different between Africa and Asia & Oceania. Models 11 and 13, which analyse Africa, show that hybrid regimes seem to have substantially higher FDIGDP than both democracies and autocracies. Being a hybrid regime in Africa should, on average, make you have 2.2 percentage points higher FDIGDP inflow than autocracies, and 2.5 percentage points higher than democracies, all else being equal. In Asia & Oceania one finds that hybrid regimes receive 0.5 percentage points more FDIGDP inflow than autocracies, while democracies have 0.6 percentage points higher than hybrid regimes. Even though the last result is not significant, one can note that the coefficient has the expected direction, opposite of that of Africa. Could it be that Africa is the reason for hybrid regimes' strong result on the main regression? A separate analysis must be done to investigate Africa's effect on the total score of hybrid regimes.

**Table 4.3: Determinants of FDIGDP, by region**

	<b>Model 9: Africa</b>	<b>Model 10: Asia &amp; Oceania</b>	<b>Model 11: Africa</b>	<b>Model 12: Asia &amp; Oceania</b>	<b>Model 13: Africa</b>	<b>Model 14: Asia &amp; Oceania</b>
<b>POLITY2</b>	.002 (0.07)	.057*** (2.84)				
<b>Hybrid versus Autocracy</b>			2.207*** (4.58)	.587* (1.96)		
<b>Hybrid versus Democracy</b>					2.506*** (3.78)	-.616 (-1.54)
<b>WAR 25</b>	1.894*** (3.59)	-.507 (-1.45)	1.553*** (2.65)	.071 (0.18)	1.517* (1.88)	-.734* (-0.10)
<b>GROWTH</b>	.282*** (9.14)	.079*** (3.09)	.280*** (8.25)	.081*** (3.21)	.348*** (7.78)	.105** (2.45)
<b>TRADE</b>	4.521*** (10.85)	2.950*** (13.51)	4.809*** (9.85)	3.164*** (12.71)	6.4*** (9.27)	3.112*** (9.76)
<b>FDI STOCK</b>	7.32e-06 (0.36)	.00001*** (5.15)	-8.16e-06 (-0.25)	.00001*** (5.81)	-6.37e-06 (-0.25)	.00001*** (3.80)
<b>CONSTANT</b>	-16.473*** (-9.29)	-10.182*** (-10.28)	-18.457*** (-9.02)	-11.803*** (-10.72)	-25.418*** (-8.4)	-10.281*** (-7.44)
<b>Observations</b>	1344	770	1062	585	826	444
<b>Countries</b>	51	31	47	29	46	21
<b>R2</b>	0.15	0.292	0.177	0.353	0.187	0.343

Source: Own calculations, based on the sources described in the text. Time period: 1980-2010.

T-statistics in parentheses.

\*, Significant on the 10% level.

\*\*, Significant on the 5% level.

\*\*\*, Significant on the 1% level

Table 4.4 investigates the results discovered in the previous analysis, where Africa gave strong results to hybrid regimes. Models 14 and 15 have POLITY2 as a political regime proxy, while models 17 and 18 measure hybrid versus democratic regimes. These models exclude Africa from the regression, and by comparing them to the former results, one can see what effect that region has. The political regime proxies are statistically significant in all models, but one can see some contradictory directions on the coefficients. This is best observed in models 3 and 17, where hybrid regimes are measured against democracies. Including Africa in the regression (model 3) gives hybrid regimes a 0.66 percentage point higher FDIGDP inflow than democracies, while excluding Africa from the regression (model 14) gives democracies a 0.56 percentage point higher FDIGDP inflow than hybrid regimes, all else being equal. This last result is further confirmed in model 15 when DOILRES and MINING is included as natural resource proxies. This gives democracies a 0.34 percentage points higher FDIGDP inflow than hybrid regimes. It is now evident that the African region

does have a substantial impact on the political regime proxy, because hybrid regimes on that continent are attracting more MNCs than they do on a world basis. This finding is in line with Okafor et. al. (2011 146): “Unlike other regions, in Sub-Saharan Africa a weak democracy increases the likelihood of foreign investments”. Even though they have tested for Sub-Saharan Africa, the results can be reckoned as in line with the analysis in this thesis. One explanation could be that hybrid regimes in Africa are more attractive for MNCs than in other parts of the world. On the contrary, it could be more likely that democracies in Africa are less attractive compared to other parts of the world, leaving hybrid regimes with higher FDIGDP inflows. This is confirmed in models 19 and 20, where a democracy dummy is compared against hybrid and autocratic regimes, first in Africa, then in the rest of the World. The results show that in Africa, democracies receive less FDIGDP inflows than hybrid and autocratic regimes. By illustration one can say that being a democracy in Africa gives approximately 1 percentage points less FDIGDP inflow than being a hybrid or autocratic regime. Comparing the same categories while excluding Africa shows that democracies will receive 0.89 percentage points more FDIGDP than hybrid and autocratic regimes. This implies that democracies in Africa are substantially less attractive for MNCs than in the rest of the World. In addition to this, because Africa receives less FDI inflow than other regions, it might be so that relatively small differences in FDI inflow between countries in that region will substantially affect the analysis.

**Table 4.4: Determinants of FDIGDP, and the effect of Africa**

	<b>Model 15: Africa is excluded</b>	<b>Model 16: Africa is excluded</b>	<b>Model 17: Africa is excluded</b>	<b>Model 18: Africa is excluded</b>	<b>Model 19: Only Africa</b>	<b>Model 20: Africa is excluded</b>
<b>POLITY2</b>	.068*** (5.29)	.051*** 3.37				
<b>Hybrid versus Democracy</b>			-.562*** (-2.69)	-.347* (-1.73)		
<b>Democracy</b>					-1.023** (-2.05)	.896*** (4.96)
<b>WAR25</b>	-.691*** (-2.81)	-.821*** (-3.2)	-.834*** (-3.28)	-.891*** (-3.88)	1.74*** (3.27)	-.589** (-2.39)
<b>GROWTH</b>	.113*** (7.29)	.125*** (6.71)	.136*** (7.35)	.139*** (7.24)	.283*** (9.23)	.115*** (7.38)
<b>TRADE</b>	2.725*** (17.29)	2.444*** (14.14)	2.853*** (16.95)	2.481*** (14.87)	4.637*** (11.09)	2.769*** (17.48)
<b>FDI STOCK</b>	.00001*** (5.96)	.00001*** (7.06)	.00001*** (5.82)	.00001*** (7.82)	9.20e-06 (0.45)	.00001*** (5.97)
<b>DOILRES</b>		-.594** (-2.35)		-.625** (-2.4)		
<b>MINING</b>		.018*** (2.73)		.032*** (4.84)		
<b>CONSTANT</b>	-8.933*** (-12.89)	-7.827*** (-9.93)	-8.912*** (-12.21)	-7.722*** (-10.46)	-16.72*** (-9.50)	-9.439*** (-13.30)
<b>Observations</b>	1866	1479	1379	1166	1344	1866
<b>Countries</b>	82	78	68	65	51	82
<b>R2</b>	0.215	0.236	0.266	0.332	0.153	0.213

Source: Own calculations, based on the sources described in the text. Time period: 1980-2010.

T-statistics in parentheses.

\*, Significant on the 10% level.

\*\*, Significant on the 5% level.

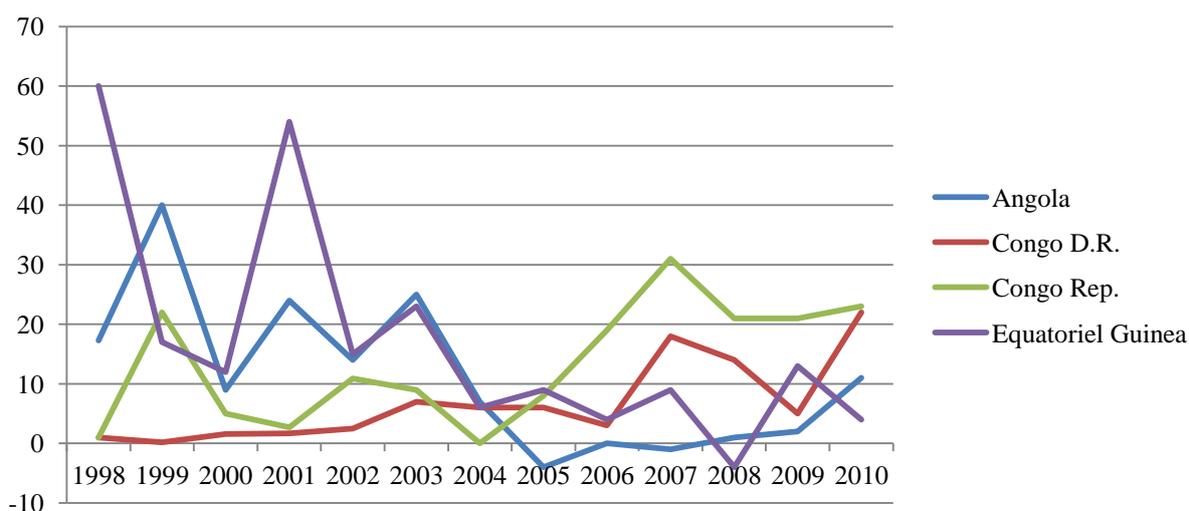
\*\*\*, Significant on the 1% level

So what can explain the different results in the African region? The explanation for this is complex, and this thesis can barely touch upon its surface. Resnick (2001) argues that political instability and higher levels of democracy deter FDI inflows, because it hampers or eliminates MNCs` potential monopoly, thereby reducing their profits. Putting this into the African context might be part of the explanation. The theory section outlined that democracies promote competitiveness and open markets, and that this will lead to economic growth, which, in theory, should attract MNCs. But Okafor et.al. (2011: 147) argue that Africa has seen a different outcome: “improved education and democracy presents a quandary for ill-guided leadership and exploitive MNCs investing in these countries by curtailing illicit profit maximization opportunities”. It is evident that Africa is a special case when one looks at economic issues combined with political explanations, exemplified by it being the poorest continent in the world (Jackson & Rosberg 1982). According to Sachs & Warner (1997: 27),

this can be explained by three conditions that hamper the continent: “landlockedness for no fewer than 14 economies; a high natural-resource dependence, with the consequent Dutch-disease costs to long term growth; and higher incidents of disease and lower life expectancy”. This implies that it creates countries that have a different functioning economy and relation to MNCs, providing contradictory results to the analysis.

Figure 4.3 highlights FDIGDP in four African countries rated as hybrid regimes. After an analysis of the countries in Africa, and their FDI inflow, these cases were selected to show how certain hybrid regimes can influence the category. Angola, the Democratic Republic of Congo, the Republic of Congo and Equatorial Guinea have several important features in common: FDI inflow is mainly within the natural resource sector, they have a weak rule of law that is viewed as highly corrupt and influenced by political leaders, weak governmental ruling and institutional accountability, and they have all been politically unstable, with civil wars and several coup d'états. All of these conditions are in theory enough to keep investors away from the regimes, but still they receive substantial FDI inflow. I argue that this has two possible explanations. Firstly, hybrid regimes in Africa have on average high levels of natural resources, giving them higher FDIGDP inflow than democratic states. Secondly, the level of GDP in these politically unstable countries are on a low level, making FDI inflow seem higher when divided by GDP. But the set of countries are interesting when one look at some of the remarkable FDIGDP inflow numbers that they have. The world average is at just over 3 percent, while these countries experience certain years with 30, 40 and 50 percent FDIGDP inflow. It is evident that natural resources are a vital part of the results seen in Africa.

**Figure 4.3: FDIGDP in selected hybrid regimes in Africa**



\*Own calculations based on FDI and GDP data from the World Bank, and democracy data from Polity IV. FDI is measured as percentage of GDP.

This section has seen an analysis of the regional effects on the results, highlighting the differences between regions like Africa and Asia & Oceania when it comes to FDIGDP inflow and political regime type. Seeing the contradictory results between these two regions, and regarding the importance of natural resources in both, the next section will investigate the effect of this on FDIGDP inflow and political regime type.

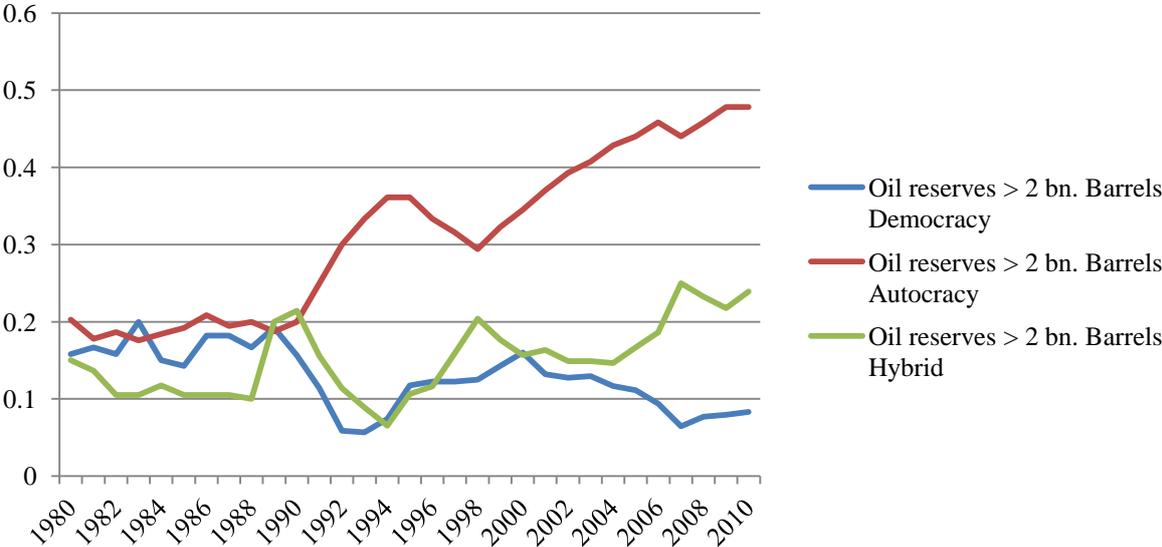
### **4.3. Natural resources**

Natural resource dependence is named one of the curses for poor economic development in Africa, but it is also a crucial part of success stories in Asia (Le Bellion, 2005). How a country's institutions can cope with and use its natural resources is important for economic growth, which will attract MNCs. Another important point to make is that companies involved in natural resource investments are less afraid of authoritarian regimes, because they are used to dealing with these states, and the potential profits are so big that they invest anyway. Natural resources are therefore included as variables in this analysis. First, I will look at the political regime categories and their natural resource abundance.

Looking at Figure 4.4, one can clearly see what political regime category that on average has most oil producers. Autocracies have since 1990 steadily increased their share of oil

producing countries, which might be because the total number of autocracies decreased much around that time. The number of autocratic regimes is still falling, and at the same time the percentage of oil producers is rising. It is then tempting to imply that it is the non-oil producers that leave the autocratic regime category, while the oil producers stay put, which is in line with the literature (Le Billon 2005, Mehlum et.al. 2006, Ross 2004). The percentage of autocratic regimes producing more than 2 bn. barrels of oil in 2010 is almost 50 percent, while hybrid and democratic regimes have approximately 25 and 9 percent, respectively.

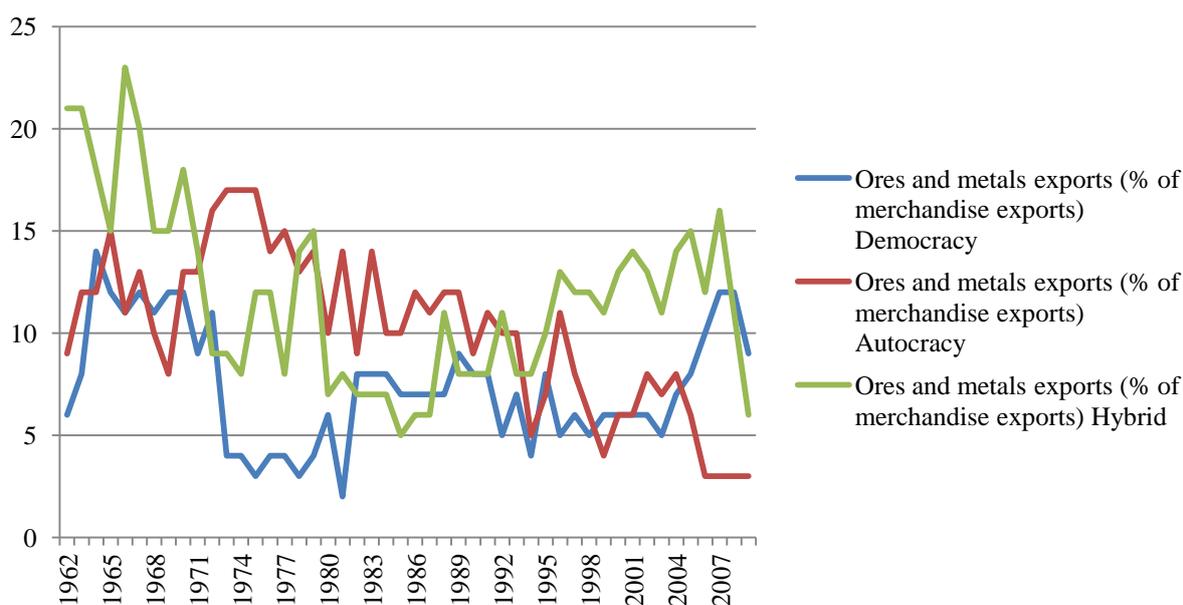
**Figure 4.4: Oil producers, by regime type**



\*Own calculations based on oil reserve data from U.S. Energy Information Administration, and democracy data from Polity IV. On this -10 to 10 scale, democracy is here defined 6 to 10, hybrid -5 to 5, and autocracy -6 to -10. OECD-countries are excluded.

The other natural resource proxy that is included in this analysis is MINING, which covers ores and metals exports, in percentage of merchandise exports. This covers important natural resources that do not correlate with oil (-0.1031). As one can see in Figure 4.5, the difference between political regimes is not the same as in the oil sector. Here one can say that the three categories follow the same levels, without any of them having much higher mining export percentage than the others.

**Figure 4.5: Ores and metals exports, by regime type**



\*Own calculations based on ores and metals exports data from the World Bank, and democracy data from Polity IV. On this -10 to 10 scale, democracy is here defined 6 to 10, hybrid -5 to 5, and autocracy -6 to -10. OECD-countries are excluded.

Table 4.5 contains models 21–23, all of which include the two natural resource variables Oil Producer and Mining. Model 21 has POLITY2 as political regime proxy, which is significant and positive. By illustration one can say that one point up on the Polity2 score (more democratic), means on average 0.04 percentage points higher FDIGDP inflow. This means that a fully fledged democracy (+10) would on average have 0.8 percentage points higher FDIGDP inflow than a totalitarian autocracy (-10). The expected direction of the coefficient for WAR25 is present, but as it is insignificant one cannot draw any conclusions. GROWTH, TRADE and FDISTOCK all show expected coefficients. Both DOILRES and MINING are significant, and do therefore affect FDIGDP inflow. Being an oil producer means that you on average have 0.4 percent less FDIGDP inflow than non-oil producers. While the more ores and metals you export as percentage of merchandise, the more FDIGDP inflow you have. This could be explained by the fact that the oil sector in many nations, especially autocratic ones, is controlled by the government through state-owned companies. As mentioned earlier in the thesis, the Argentine government recently seized the Spanish oil firm Repsols stakes in the local Argentine oil company YPF (Forero 2012). In 1938, the Mexican President Lázaro Cárdenas expropriated all oil reserves, facilities, and foreign oil companies in the country. Today, the national oil company Pemex is Latin Americas largest corporation and still has a

monopoly over the Mexican petroleum industry (Sancho 2012). A similar example is found in Saudi-Arabia, where the nationalized oil company Saudi Aramco now is the largest single company in the world.

The mining sectors are in general often more open for foreign investors, which could be the reason for its positive correlation with the dependent variable. In model 22 the political regime proxy, hybrid versus autocracy, is significant and positive. Hybrid regimes have on average 0.6 percentage point higher FDIGDP inflow than autocratic regimes, which is down from 1.5 percentage point when natural resources were not included (model 2). The two natural resource proxies show similar scores as in model 21, and can be said to meet expectations. Model 23 has an insignificant political regime variable, but the inclusion of natural resources has changed the coefficient into becoming negative, which is in line with previous academic findings. WAR25 does become significant in model 23, and has a negative coefficient, which means that countries that have not had more than 25 conflict related-deaths within one year, have in average 0.5 percentage point higher FDIGDP inflow than those which have more. This is in line with the expectations which say that internal conflict keeps foreign investors away. The natural resource coefficients are similar to models 21 and 22, proving that the oil sector has a negative impact on FDIGDP inflow, while mining has a positive effect. The R2s for model 21 and 22 is just over 0.2, showing a moderate relationship. While model 23 gets an R2 at 0.27, which by the rule of thumb (Acock 2008) is close to a strong model fit.

**Table 4.5: Determinants of FDIGDP, and the effect of Natural resources**

	<b>Model 21:</b>	<b>Model 22:</b>	<b>Model 23:</b>
<b>POLITY2</b>	.041*** (3.61)		
<b>Hybrid versus Autocracy</b>		.621*** (2.59)	
<b>Hybrid versus Democracy</b>			-.119 (-0.75)
<b>WAR25</b>	-.322 (-1.58)	.084 (0.27)	-.516*** (-2.57)
<b>GROWTH</b>	.116*** (7.47)	.106*** (4.95)	.136*** (7.89)
<b>TRADE</b>	2.42*** (16.96)	2.59*** (12.43)	2.523*** (16.93)
<b>FDISTOCK</b>	.00001*** (7.42)	.00001*** (5.55)	.00001*** (7.58)
<b>DOILRES</b>	-.406** (-2)	-.481* (-1.74)	-.4* (-1.72)
<b>MINING</b>	.024*** (5.38)	.021*** (3.42)	.029*** (6.06)
<b>CONSTANT</b>	-7.927*** (-12.65)	-9.142*** (-10.1)	-8.122*** (-12.46)
<b>Countries</b>	124	95	91
<b>Observations</b>	2178	1183	1648
<b>R2</b>	0.213	0.208	0.278

Source: Own calculations, based on the sources described in the text. Time period: 1980-2010.

T-statistics in parentheses.

\*, Significant on the 10% level.

\*\*, Significant on the 5% level.

\*\*\*, Significant on the 1% level

Table 4.5 introduced the two natural resource variables DOILRES and MINING, with two different outcomes on the coefficient. While exporting ores and metals on average leads to higher levels of FDIGDP inflows, oil producers receive less than non-oil producers. The section on regional differences introduced poor economic performance in Africa and resource dependence, which together with weak institutions can hamper economic growth. The resource curse has been a debated theory for some time (Le Billon 2005, Lujala 2010, Mehlum et.al. 2006, Ross 2004), bringing several explanations with it that are valid in this research. Firstly, poor economic growth and exposure to shock are proven to correlate with natural resources. This means that countries benefiting from a wealth of natural resources on average experience lower economic growth (The Economist 2011a). MNCs will in general be attracted to markets and countries that are experiencing strong economic growth. Secondly, high levels of corruption are on average more common in countries with natural resources than in those with no natural resources. This is confirmed when a correlation test is run

between corruption and oil producer/non-oil producer. The score of  $-.136$  for oil producers, and  $.018$  for non-oil producers, shows that there is more corruption in oil-producing countries. This is especially so in less developed economies where weak institutions open up the opportunity for actors to misuse the power given to them (The Economist 2011a). Countries with high corruption are not attractive for foreign investors. Thirdly, as we saw in the Figure 4.4 above, authoritarian regimes are the regime type in many countries with a wealth of natural resources. This often brings about poor governance, which can be vital for multinationals. Fourthly, countries with a high level of natural resources are often prone to the risk of civil war, especially when the level of exports is high in percentage of GDP (Le Billon, 2005, Lujala 2010, Ross 2004). As this thesis outlined in the theory section, countries with internal conflict are not attractive for MNCs, which want stability and security protecting their investments.

Table 8.3 provides an overview of what countries that is within each regime category in 2010. It is striking to see how few democratic countries that are rich and dependent on natural resources, while there are many big oil producers within the autocratic category. Investigating the hybrid regimes, one notice that many countries is natural resource dependent, especially in the African continent. Figure 4.3 outline four of these countries, providing the argument that the hybrid regime score in FDI inflow depends on few companies within the natural resource sector. This is confirmed when I run a regression that excludes oil producers, and big ores and metals exporters. The coefficient for Hybrid is reduced from  $1.073$ , down to  $0.29$ , indicating that the strength of FDI inflow depends on the countries with natural resources.

This section completes the analysis done in this thesis, with many interesting findings that can shed light on the questions raised in the introduction. The next chapter will discuss this empirical evidence in regards to the theory and expectations, for hybrid regimes relation to FDI inflow.

## 5. Explaining FDI in Hybrid Regimes

This thesis has so far presented a theory which provides a foundation for building up an expectation for the upcoming analysis. It then introduced the methodology for the analysis, with its pros and cons, together with the chosen variables and hypotheses. The chapter above described and to some extent discussed the findings from the analysis. The present section will discuss these results in light of the theory and former research, and present an answer to the two hypotheses for this thesis.

To briefly recapitulate the theory presented in the beginning of this thesis, one will have to focus on two important points: what do MNCs seek when investing abroad, and what conditions are present for FDI in democratic-, autocratic-, and hybrid regimes? The former saw a focus on the need for status quo and stability, both when it comes to regimes and their policies. Foreign firms seek regimes and markets that can provide predictable conditions for their investments, and secure long-term profitability. A well functioning government with veto players is, together with the protection of property rights, the most important factors in securing their investments. But as firms do seek profitability, they also need to confront risks. It is a fact that markets that have not yet reached their potential, often are found in developing countries and markets. There are many reasons to why these nations are not fully economically developed, but weak governments and an unsecure investment climate often scare away MNCs. They will need to weigh the two factors, profitability and risk, up against each other, and see if the potential market is worth investing in. The regional effects on the results discussed how some hybrid regimes in Africa rich on natural resources attract foreign investors, even though they are political unstable, lack governmental efficiency, have low protection of property rights and weak economic policies. I argue that the political regime effect will only be important for MNCs to a certain degree, and it becomes less important when the potential profit is high. This is apparent in the natural resource sector, where MNCs usually operate within regimes that are challenging when it comes to political risk.

The theory section also outlined different expectations concerning which political regime type receive the highest amount of FDIGDP inflow. Through a strong rule of law, low levels of corruption, a high number of veto players, and a well-functioning government and

institutions, democracy is by many regarded as the most attractive political regime in which to invest. This was also evident when one looked at former empirical results, where many academics have reported similar findings. On the contrary, some scholars argue that regime stability, the ability to provide tempting economic features, and potential monopolistic market positions, make autocracies the best regimes for MNCs. The section on hybrid regimes outlined instability, especially in policies, weak governments and institutions, internal conflict and civil war, and bad economic development as reasons for why MNCs would not prefer investing in this regime type. As the thesis set out to investigate how hybrid regimes' levels of FDIGDP inflows are compared to democratic and autocratic regimes, two hypotheses were outlined on the basis of the theory:

*Hypotheses 1:* Democratic regimes attract more FDIGDP than hybrid regimes.

*Hypotheses 2:* Autocratic regimes attract more FDIGDP than hybrid regimes.

The analysis has provided many interesting findings, including results that can bring us to conclusions concerning the two hypotheses. To give a short conclusion on these two hypotheses, on the basis of the findings in this analysis, one can say that: hypothesis 1 can *partly be supported*, and hypothesis 2 is *rejected*.

The analysis in table 4.1, model 2, gave a clear indication that hybrid regimes on average receive higher levels of FDIGDP inflows than autocratic regimes. This was confirmed in the later analysis done to control for regional effects and natural resources, where all coefficients supported the hybrid regime type in being more attractive for MNCs. Drawing a conclusion on hypothesis 2 is therefore straightforward. On the contrary are the results concerning hybrid versus democratic regimes when it comes to FDIGDP inflows, which were more complicated to clarify. Table 4.1, model 4, started this confusion when it showed that hybrid regimes on average receive more FDIGDP inflow than democratic regimes, which contradicts hypothesis 1 and big parts of the academic field's former research. Tables 4.3 and 4.4 provided useful insight on this question, showing that regional differences are present, especially is the case of Africa, that greatly influence the result in model 4. This becomes clear in models 13 and 17, where the former analyses the two regime types within Africa, and the latter analyse these two on a world scale, but leaving the region Africa out of the regression. Hybrid regimes in Africa

do on average attract 2.5 percentage points higher FDIGDP inflow than democratic regimes, all else being equal, while the score is turned over on the world basis, with democracies have 0.5 percentage points higher, all else being equal. In essence this means that the region Africa contributes to a turn in the hybrid versus democracy score. The question then is why this continent creates results that are different from the world average. Table 4.3, models 11 and 13, indicates that the relative position of hybrid regimes is stronger contra democracies and autocracies when comparing it to the World average, implying that hybrid regimes in Africa are more attractive for FDI than in other regions. At the same time one can conclude that democracies in Africa score much lower on average than in the rest of the world. Democratic regimes in Africa receive on average 1 percentage points less FDIGDP inflow than hybrid and autocratic regimes, while democratic regimes on a world basis (excluding Africa) receive 0.89 percentage points higher FDIGDP inflow, all else being equal. I argue that this strengthens the theoretical framework that highlights four factors that are important to foreign investors. Because what is regarded as democratic states in Africa, can still be weak states when it comes to some of these conditions (Jackson & Rosberg 1982). By illustration, the likes of Mali, Senegal, and Sierra Leone are in 2010 regarded as democracies by Polity IV and my regime categorization. These countries do not necessarily provide an exceptional rule of law, nor are they very stable, with the coup d'état in Mali in 2012 as the last example (Nossiter 2012). Since this country is not rich on natural resources, they will struggle to attract any big amounts of FDI inflow. While a hybrid regime that have some of the same instability problems, often have natural resources, and hence do get a higher FDIGDP level. Had the conditions for investment been better in Mali, like they are in another democratic developing country like Indonesia, they too will attract MNCs.

What this analysis has shown is that foreign direct investment is a complex subject that is influenced by many variables. Among these are political regime type, and its different components: *Rule of law, number of veto players, political participation rights, and government functioning*. The theory section discussed how the three regime types are different when it comes to these factors, implying that democracies would attract most FDI inflow. This was confirmed by the analysis, which also showed that hybrid regimes receive more than autocracies. I argue that hybrid regimes often will lack some democratic features within its society, but that they do have certain conditions that will attract MNCs; they therefore receive

more FDI inflow than autocracies. Further I argue that many hybrid regimes are rich on natural resources, and hence therefore do attract certain MNCs that are used to coping with challenging investment conditions.

## 6. Conclusion

The rationale behind the investigation of this thesis was to explore what political regime type attracts most FDI inflow, with a special focus on hybrid regimes. The academic literature have in most cases found that democracies are the preferred regime type to make investments in, but there has not been any study exploring the case of hybrid regimes. What regime type attracts most FDI inflow? How can FDI inflow in hybrid regimes be explained? These were questions asked in the making of this thesis.

The thesis discussed the theoretical framework for the analysis in chapter 2. Firstly, a presentation of important factors for MNCs when they invest abroad, especially related to political regime type. Reviewing the literature, I found that four aspects of a regime are vital for foreign firms: *rule of law*, *veto players and accountability*, *political participation and civil liberties*, and *governmental functioning*. If all of these conditions are provided for in a regime, it will most likely be stable, and predicting future profit is easier for MNCs. Secondly, followed a presentation of democratic, autocratic, and hybrid regimes, in relation to the factors mentioned above. Investigating the literature, I found that democracies had the best set up for attracting foreign investors, and there were also arguments for why autocracies receive FDI inflow. Because there had not been former studies on hybrid regimes, I had to look into other fields of studies and especially the focus on political instability and civil wars led me to believe that hybrid regimes were unattractive for MNCs (Gates et.al. 2006, Gurses et.al. 2010, Hegre et.al. 2001, Lujala 2010, Ross 2004).

The analysis of this thesis was presented in chapter 4, with the first section exploring the basic relationship between political regimes and FDI inflow. The results showed that hybrid regimes received most FDI inflow, which was against the theoretical expectations. Democracies came second, and autocracies scored lowest on all models. Further investigation of this surprising finding showed that Africa was the reason, with the expected result occurring when excluding the continent. It is evident that certain hybrid regimes in Africa produce high levels of FDI inflow in percentage of GDP. Angola, the Democratic Republic of Congo, Republic of Congo, and Equatorial Guinea are among these states that all are rich on natural resources, but in general score very low on the four investment-friendly factors

outlined in the theory. This illustrates how challenging this type of research is, in that there can be many variables affecting FDI inflows. The analysis further found that democracies in Africa received lower levels of FDI inflow than in the rest of the world. I argue that this is because the four conditions mentioned above are not secured in a satisfying way in many African democracies. And with no natural resources present in the country, they will receive low levels of FDI inflow. The conclusion for this thesis is that hybrid regimes receive more FDI inflow than autocracies, while it receive less than democracies, except for the case of Africa, where it attracts most of all regime types.

This research was unique because it investigated the relationship between political regimes and FDI inflow in a new way, by dividing them into democratic, autocratic, and hybrid regimes. The findings has enriched the academic debate by providing knowledge of the political regime sphere between democracies and autocracies, which often is the sole focus in most studies. This field has a big potential for further research, both by case studies and empirical studies. In light of the “Arab spring” I argue that the future will see even more autocracies turning into hybrid regimes, bringing more democratic features into the world investment climate. But as this thesis has showed, states making the transition into the hybrid category, often stays there. And even though many countries now are facing a transition and struggle towards democracy, they might never reach a fully fledged democratic status. This argument is strengthened by the resource curse, implying that these societies will struggle with the likes of ineffective government, corruption, and political instability, making them less attractive for MNCs (Le Billon 2005, Lujala 2010, Ross 2004).

This thesis has produced interesting findings that both answer the initial question of what regime type that attracts the most FDI inflow, and show how complex the subject is. The multidimensional field of FDI are affected by political regimes and their investment conditions, but the quest for profitability will often overshadow the risk of investing in non-democracies.

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## 8. Appendix

*Table 8.1: Descriptive statistics*

Variable	N	Mean	Std. Dev.	Min.	Max
<b>FDIGDP</b>	4897	3.265	7.335	-82.892	145.201
<b>POLITY2</b>	5848	-1.170	6.905	-10	10
<b>WAR25</b>	9541	.115	.319	0	1
<b>VANHANEN</b>	5288	13.5813	12.85882	0	49
<b>IPEFREE</b>	4085	6.011176	1.151128	2.3	9.08
<b>GROWTH</b>	6551	1.967	6.836	-50.290	147.548
<b>TRADE</b>	5907	4.183	.655	-1.175	6.1
<b>FDISTOCK</b>	4862	9658.599	47288.63	0	1177536
<b>DOILRES</b>	4634	5.886	25.333	0	266.81
<b>MINING</b>	4283	9.581	18.256	0	158.493
<b>GDPPC</b>	6513	7.277	1.455	4.056	11.59
<b>Voice and Accountability</b>	2353	-.255	.916	-2.290	1.619
<b>Political stability</b>	2290	-.231	.971	-3.311	1.596
<b>Government Efficiency</b>	2243	-.295	.819	-2.495	2.267
<b>Regulatory Quality</b>	2271	-.265	.891	-2.841	3.345
<b>Rule by law</b>	2303	-.303	.841	-2.691	1.728
<b>Control of Corruption</b>	2246	-.294	.806	-2.489	2.280

*Table 8.2: Correlation between the main variables of interest*

	<b>POLITY2</b>	<b>Freedom House</b>	<b>WAR25</b>	<b>VANHANEN</b>	<b>IPEFREE</b>
<b>POLITY2</b>	1.0000				
<b>Freedom House</b>	0.8691	1.0000			
<b>WAR25</b>	-0.0915	-0.2127	1.0000		
<b>VANHANEN</b>	0.8049	0.8024	-0.1375	1.0000	
<b>IPEFREE</b>	0.4759	0.5353	-0.2776	0.5100	1.0000

**Table 8.3: Political Regime categorization in 2010**

<b>Democracies</b>	<b>Autocracies</b>	<b>Hybrid</b>
Albania	United Arab Emirates	Angola
Argentina	Azerbaijan	Armenia
Burundi	Bahrain	Burkina Faso
Benin	Belarus	Bangladesh
Bulgaria	China	Bhutan
Bolivia	Cuba	Central African Republic
Brazil	Eritrea	Cote d'Ivoire
Botswana	Iran, Islamic Rep.	Cameroon
Colombia	Kazakhstan	Congo, Dem. Rep.
Comoros	Kuwait	Congo, Rep.
Cape Verde	Lao PDR	Djibouti
Costa Rica	Libya	Algeria
Cyprus	Morocco	Ecuador
Dominican Republic	Myanmar	Egypt, Arab Rep.
Georgia	Oman	Ethiopia
Ghana	Korea, Dem. Rep.	Fiji
Guinea-Bissau	Qatar	Gabon
Guatemala	Saudi Arabia	Guinea
Guyana	Swaziland	Gambia, The
Honduras	Syrian Arab Republic	Equatorial Guinea
Croatia	Turkmenistan	Haiti
Indonesia	Uzbekistan	Iraq
India	Vietnam	Jordan
Jamaica		Cambodia
Kenya		Sri Lanka
Kyrgyz Republic		Madagascar
Kosovo		Mozambique
Lebanon		Mauritania
Liberia		Niger
Lesotho		Nigeria
Lithuania		Papua New Guinea
Latvia		Russian Federation
Moldova		Rwanda
Macedonia, FYR		Sudan
Mali		Singapore
Montenegro		Somalia
Mongolia		Chad
Mauritius		Togo
Malawi		Thailand
Malaysia		Tajikistan
Namibia		Tunisia
Nicaragua		Tanzania
Nepal		Uganda
Pakistan		Venezuela, RB
Panama		Yemen, Rep.
Peru		Zimbabwe
Philippines		
Paraguay		
Romania		
Senegal		
Solomon Islands		
Sierra Leone		
El Salvador		
Serbia		
Timor-Leste		
Trinidad and Tobago		
Ukraine		
Uruguay		
South Africa		
Zambia		

\*Own categorization based on democracy data from Polity IV. On this -10 to 10 scale, democracy is here defined 6 to 10, hybrid -5 to 5, and autocracy -6 to -10. OECD-countries are excluded.