No Strings Attached? FDI, Ideology, and Levels of Democracy in Latin America

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Recommended Citation
No Strings Attached? FDI, Ideology, and Levels of Democracy in Latin America

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April 28, 2020
Abstract

How does foreign direct investment (FDI) affect the levels of democracy in developing states when taking their political ideologies into consideration? Scholars have traditionally viewed FDI as conducive to economic and political liberalization in developing countries. However, few studies have analyzed the effects of FDI on democracy or how the political ideologies of host governments might condition the effects of FDI. This investigation identifies two separate types of FDI at play in Latin America—state-led and market-led FDI—epitomized by Chinese and American multinational corporations (MNCs), respectively. I hypothesize that state-led FDI will have no effect on the levels of democracy in Latin America and no preference towards regime ideology due to a lack of precedent in the literature. In contrast, market-led FDI will increase levels of democracy due to its propensity to open domestic economies to international influence. However, depending on regime ideology, the effects of FDI on levels of democracy will vary. This paper tests the effects of market-led and state-led FDI on levels of democracy in Latin America from 2003 to 2012 through time-series, cross-sectional OLS regressions. Results show a general, negative effect from state-led and market-led FDI on democracy. Although, when considering the interaction between ideology and FDI, US and Chinese MNCs positively influence the democracies of politically conservative regimes and negatively influence politically liberal regimes.
Introduction

In November 2019, President Jair Bolsonaro of Brazil refused to host fellow BRICS representatives that did not accept Juan Guaidó as the current president of Venezuela at an important outreach summit; however, Bolsonaro still invited the Chinese president, Xi Jinping, to this summit (Stuenkel, 2019). Bolsonaro and Jinping are working to salvage a formerly dysfunctional relationship. Relations between China and Brazil have been strained since Bolsonaro took office, with Bolsonaro’s visit to Taiwan and declarations that China is “buying Brazil” in reference to the Chinese mining of Brazilian rare earth minerals (Lapper, 2019). Due to Bolsonaro’s deep conservatism and distaste for communism, one would expect the relationship between China and Brazil to continue to deteriorate. However, Chinese diplomats and investors have endured Bolsonaro’s opening blows, and their bilateral relationship has stabilized. This peculiar situation highlights an example through which I will investigate the international political economy of state-led and market-led investment influences on Latin American democracies. Chinese investors are concerned with making economic gains and promoting their firms abroad, despite their own political preferences or those of the countries in which they invest. Does Chinese FDI influence the Brazilian regime’s ideology? Does this potential trend extend into the rest of Latin America?

The determinants of foreign direct investment (FDI) have been thoroughly investigated by existing literature, and FDI is commonly perceived as a signal of both economic liberalization and the consolidation of democracy in host economies. However, FDI’s actual ramifications leave much to be studied. Scholars and policymakers assume that FDI always benefits developing countries, but FDI recipients may not be eager for MNC influence. Large investment packages can exacerbate corruption, increase dependency, and weaken accountability through their reliance on said funding for social programs and other governmental expenses (Buthe & Milner, 2008). Mathur and Singh (2013) find that more democratic regimes receive less FDI due to their guarantees of political freedom without economic freedom, further complicating the relationship between FDI and differing characteristics of host governments. Due to the significant consequences of FDI and ideology on levels of democracy, FDI literature needs to address the ramifications of FDI on the democratic atmospheres of developing regions. Is there an interplay between FDI and ideological leaning? Does FDI foster democratic consolidation? Is FDI as beneficial as existing literature posits?

I intend to disaggregate FDI by sender in the context of Latin America. A hegemonic competition currently exists in the region between the United States and China, and these countries’ FDI practices exemplify two alternative strategies of investment. I argue that Chinese FDI is state-led and serves different purposes than US FDI, which I classify as market-led. Their hegemonic competition will highlight at what lengths their MNCs will go to procure deals and profit and may hint at the ideological preferences of their respective MNCs or governments in general. I will articulate the effects of FDI in a confined geographic area along with studies such as Gholipour Fereidouni, Ariffin Masron, and Ekhtiari Amiri (2011) and Resnick (2001).

This investigation contributes to the literature of democratization and FDI by investigating the effects of FDI on democracy and goes beyond previous research on the effects of FDI by considering the mediating effect of regime ideology. Previous studies by de Soysa (2003), Reuveny and Li (2003), and Sun (2014) have analyzed FDI’s impact on democracy and provide the theoretical foundation for core elements of this research. But these studies do not
disaggregate FDI by sender. The commonplace assumption is that FDI is beneficial for democracy, but by disaggregating the origins of the foreign investment and the goals of the investors, this thesis aims to evaluate the relevance of this assumption across contexts. Moreover, I explore the differences that Chinese and US investors exhibit through conceptualizing two types of FDI: market-led and state-led. These FDI classifications apply outside of the competition between the US and China—and beyond the Latin American context—as they take the investment practices and both the geopolitical and economic interests of firms into account. My investigation opens a larger discussion into the political traits of FDI, the relationship between FDI, ideology, and democracy, and the methods that certain firms use to implement FDI.

**Theory**

While a decent-sized literature exists describing the general effect of FDI on regime change, the role that FDI plays in manipulating democracy throughout the modern history of Latin America has not yet been investigated. Some studies (de Soysa, 2003; Reuveny & Li, 2003; Sun, 2014) have analyzed the effects of long-term FDI on levels of democracy throughout the world, but only Sun (2014) looks at data after 2000. None of these studies disaggregate FDI by sender or analyze FDI’s traits within the scope of Latin America’s political and social contexts.

Garland and Biglaiser define FDI as “assets in which at least 10% of the voting stock is controlled by investors in a country outside of where the enterprise is located,” often bringing along benefits such as increased trade, technology transfer, and job opportunities (2008, p. 232). Numerous authors have addressed FDI as an economic concept, with its main determinant being the assured protection of private property (Biglaiser & Staats, 2009; Jensen, 2003; Li, 2006). An abundance of natural resources attracts FDI regardless of regime type (Asiedu & Lien, 2011; Dosch & Goodman, 2012; Garland & Biglaiser, 2008; Shapiro, Vecino, & Li, 2018). Trade and FDI are considered complements in the international political economy (Buthe & Milner, 2008), and greater state capacity paired with strong regulatory quality attracts FDI (Biglaiser & Danis, 2002; Biglaiser & Staats, 2009; Subasat & Bellos, 2013). I view FDI as emblematic of large monetary inflows, as FDI “may lead to increased tax revenue, greater productivity of domestic firms, and spillover effects of technology transfers” (Tomashesvskiy, 2017, p. 410). These monetary flows represent firm-level economic activity in the host country and do not reflect on the general population, as their funds are restricted to businesses and government. Thus, the resulting effects of FDI are contingent on the characteristics of the host economy. The intentions of MNC investment in the region and the political environments of investment locations are all important in determining the outcomes of FDI on host economies.

Political ideology and regime change are further theoretical considerations for FDI and its usage in this project. Conceptual definitions of ideology vary widely from the most basic—“a set of idea-elements that are bound together” (Gerring, 1997, p. 980)—to that which I will use in this project: an “orientation to political parties…[resulting from] a partisan struggle” (Martin, 2015, p. 11). On an ideological scale from extreme leftist (or liberal) to extreme rightist (or conservative), most leftist governments support greater state-spending and social programs, whereas most rightist governments advocate for smaller government, less state spending, and larger militaries. Political parties in Latin America hold common distastes for the International Monetary Fund (IMF) and neoliberalism, as well as general favor towards social welfare
programs (Baker & Greene, 2011). The political ideology of a government may exacerbate flows of FDI, depending on the ruling party’s sympathies and its preferred policies. Political ideology is important in the context of this project due to its potential applications in democratization and FDI literature. If FDI is largely collecting in more conservative regimes, then more liberal regimes will not have access to the same flows of capital and their subsequent economic liberalization. This trend perpetuates an atmosphere in which one ideology is preferred by Latin American governments solely due to the whims of MNCs. In this project, political ideology and its interaction with FDI are the primary focus in an attempt to differentiate the sources and methods of FDI. This investigation will assist other studies in the deeper exploration of ideology’s impact in conjunction with FDI on developing and developed host economies. No literature currently exists relating political ideology and bilateral FDI, so this investigation will be the first to determine a relationship between these two concepts.

Regime type indicates a state’s democracy or autocracy along a gradient. It is an important factor when investigating international relations within a regional context, as its characteristics when shifting include political violence, instability, and democratic backsliding. Mature democratic regimes are much less likely to experience democratic backsliding, though poor economic conditions can facilitate this autocratic turnaround (Svolik, 2008). Democratic backsliding in consolidated democracies is not expected; instead, the regime change is more likely found in weak democracies and electoral autocracies. As such, it is a worthwhile endeavor to find if Chinese or US FDI has any impact on regime change throughout Latin America. Additionally, governments with high degrees of accountability must take care to appease their constituencies when allowing MNCs to enter and assume the role of popular domestic corporations, as MNCs oftentimes usurp the roles of important domestic corporations and cause unrest (Biglaiser & McGauvran, 2018). Sun (2014) finds that in developing countries, FDI exerts a negative impact on levels of democracy; however, FDI from developed democracies has a positive impact on developing democracies. Reuveny and Li (2003) find that in the long-term, FDI positively impacts levels of democracy in host countries. Indra de Soysa (2003) concludes that FDI stocks per GDP has a small, positive effect on democratization when observing FDI practices in the long-run. These studies investigate the role that FDI has played in politically liberalizing and democratizing host economies.

This project argues that FDI directly affects two determinants of regime change: economic and political liberalization. In turn, FDI determines how a regime may alter to fit international whims or resist modernizing influences. Economic liberalization, as argued by Boix and Stokes (2003, p. 545), “both causes democracy and sustains it.”

Regarding economic liberalization, MNCs use FDI to increase their reach and profitability by entering international markets and gaining access to certain desirable resources. Economic liberalization begins with an opening of domestic markets to outside influences in an attempt to maintain the same structure with greater profitability (Przeworski, 1991). Most FDI is attracted to countries implementing IMF austerity measures (Biglaiser & Danis, 2002), “individualized incentives” for investors (Garland & Biglaiser, 2008, p. 241), and large sources of labor that increase their productivity and profit margins (Pandya, 2014). Economic liberalization assures host countries that it will be beneficial to both parties, and the greater inflows of liquid assets bolster the host economy. If host economies want to attract more international investment, they must liberalize their economies further. Thus, the process of
economic liberalization spurs future liberalization and success for both parties. Economic liberalization is a key factor in the process that FDI influences change in levels of democracy.

Political liberalization, on the other hand, is theoretically murky. It is a determinant of consolidated democracies and encourages progressive reforms like increased government transparency, minority enfranchisement, and free and fair voting procedures (Simmons & Elkins, 2004). Developing regimes bear the further political responsibility of assuaging traditionally western MNC fears of socialism and autocratic transitions. Developing nations are seen as riskier by international investors, so they must take care not to startle the international economy or scare investors away. Ecuadorian President Lenin Moreno’s recent adherence to IMF austerity measures highlights the importance of assuring risk-averse MNCs future economic stability, as many US MNCs would not restart investment in Ecuador if the fear of socialist upheaval persisted (Solano & Armario, 2019). Moreover, austerity measures are a sure-fire way to excite investors on upcoming investment opportunities. Whether autocratic or democratic, some MNCs only desire a stable platform to do business, and this desire predicts that international influence will reduce political instability without politically liberalizing host economies. Regardless of regime type, they will bolster the current government of the host economy.

Political and economic liberalization work together to improve the outlook of less democratic countries. FDI signals economic openness and further expands economic liberalization via liberal reforms. On the other hand, increases and decreases in political liberalization do not guarantee further FDI. In the bilateral relations between China and Brazil, President Xi Jinping and the Chinese Communist Party maintain their high levels of FDI and economic relationship with Brazil and President Bolsonaro despite the fact that Brazil’s ruling party is vehemently opposed to communism and China’s influence in Latin America. China is economically liberalizing Brazil through its FDI outflows while simultaneously watching Brazil politically de-liberalize without any desire to interfere. Mathur and Singh (2013) find that political freedoms in host economies are essentially meaningless to MNCs, as MNCs are much more concerned with guaranteed economic liberties. Therefore, economic liberalization is needed to soothe the fears of MNCs, while political liberalization is needed to further consolidate a nation’s democracy. The massive amounts of foreign investment acquired by host governments often changes the way that the host governments view the world economy. Political parties formerly opposing globalization’s effect on their nations may about-face when they become accustomed to the foreign investment. In the long term, this process eventually promotes globalization and MNC operations within parties that formerly rejected global influence. Through the fluctuation of foreign capital in domestic economies and the desire of these domestic economies to continually receive FDI, economic liberalization and political liberalization work together to democratize countries.

Throughout the course of this investigation, a stark contrast between the methods of FDI emerges. One variant of FDI, henceforth referred to as market-led FDI, follows conventional FDI practices found within academic literature. These practices include increasing human capital abroad by training and educating foreign workers in advanced extractive or manufacturing techniques, employing foreign workers, and sharing technology with host countries (Biglaiser & Staats, 2009; Jensen, 2003; Li, 2006). Host regimes realize that international investment is contingent upon the implementation of certain liberal policies that will not drastically change the status quo, such as greater protection of private property, and will act to implement such policies. On the other hand, FDI diverging from these practices will be coined as state-led FDI. Generally,
this FDI acts in the best interests of its home state. State-led FDI distances itself from the regular expectations of FDI because of its proximity to the state and its geopolitical aims. A prominent user of state-led FDI is China. Chinese MNCs function with a “‘staggeringly high’ level of government influence” and operate in an isolated fashion—China uses its own workers, imports its own technology, and rarely trains the local population to work in its industries (Shapiro et al., 2018, p. 12). These MNCs look out for the best interests of the state and have their economic decisions approved by the state. However, neither FDI variant acts in the interests of its host country; these MNCs are operating to make a profit and extract resources in the cheapest, most efficient manner. By no means are these strict definitions of FDI practices: each country practices and regulates FDI according to its own interests, though these characteristics generally fall between market-led and state-led FDI.

As greater amounts of state-led FDI are invested into states, the states become more economically liberalized but not necessarily politically liberalized. On the other hand, as states receive more market-led FDI, I hypothesize that they will economically and politically liberalize. Low amounts of both state-led and market-led FDI spur small changes within states, but state-led FDI’s greatest impact is seen in how it increases economic liberalization without liberalizing the state politically. When there are high levels of both state-led and market-led FDI within a country, I solely predict greater economic liberalization due to the flow of international capital. Table 1 summarizes the traits of state-led and market-led FDI concisely. These methods of investment have differing impacts on their host economies.

<table>
<thead>
<tr>
<th>Market-led FDI Characteristics</th>
<th>State-led FDI Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technological spillover, development of local human capital, privately driven, attracted to regime stability and property protection, risk averse, developing nations seen as riskier investments</td>
<td>Usage of state technology and workers, state driven, isolated, attracted to primary resources, not dissuaded by regime instability, risk neutral, developing nations seen as riskier investments</td>
</tr>
</tbody>
</table>

Since market-led FDI develops its host countries through technological innovation, economic interests, and attraction to stable regimes with property protections, host countries will promote democratic behaviors in order to maintain FDI. Host countries will not willingly give up large amounts of FDI if it can be helped. Additionally, the influx of FDI—which is money strictly for economic development—will diffuse throughout the host economy and encourage both economic reform and further investment. Therefore, market-led FDI liberalizes regimes, politically and economically. Since I posit that market-led FDI has positive effects on both economic and political liberalization, my hypothesis is as follows:

**H1: Market-led FDI increases the levels of democracy in Latin America.**

State-led FDI economically liberalizes host economies through its development of the primary sector and enhanced trade agreements. “Primatization” is a process through which developing economies that host FDI devolve from diversified economies into single-export economies based around sectors that have high concentrations of FDI (Dosch & Goodman,
2012). These economies lose their manufacturing abilities and become susceptible to commodity price fluctuations in the world economy. In Latin America, this issue arises in Chinese MNCs’ desires for natural resources (Dosch & Goodman, 2012, p. 10). While privatization has detrimental long-term implications, the short-run results favor host economies with attractive investment deals and lucrative resource extraction packages. Sun (2014) points out that state-sponsored MNCs will pursue both economic objectives and state geopolitical pursuits through FDI. State-led FDI does not politically liberalize regimes, as it entrenches the status quo in each of its host regimes and often serves the ulterior motives of its sender. Whether autocratic or democratic, state-led FDI prefers stability. Thus, state-led FDI liberalizes economically through its influx of liquid assets, but not politically due to its development and geopolitical concerns. I consider market-led and state-led FDI to be fundamentally different, and I cannot theoretically predict whether the positive effect of state-led FDI on economic liberalization or negative effect of state-led FDI on political liberalization will weigh more heavily. Due to this theoretical impasse, I hypothesize:

**H2: State-led FDI has no effect on levels of democracy in Latin America.**

If an MNC finds a regime’s politics agreeable, it may invest more money into said regime. Likewise, MNCs may avoid regimes that they find politically disagreeable. Theoretically, political ideology enters here. Political ideology guides MNCs towards certain nations or sectors that support their state or the current international order. Rightwing regimes are much more receptive to the investment and influence of MNCs, as they encourage the privatization of economic sectors and approve of austerity measures (Biglaiser & Danis, 2002). More conservative governments encourage economic liberalization due to their interconnectedness with the international economy. Regarding political liberalization, more conservative governments are expected to mesh well with market-led MNCs and have their democracies promoted due to the norms of their home governments and IMF measures. Since market-led MNCs encourage both political and economic liberalization, I hypothesize that:

**H3: The interaction between conservative ideology and market-led FDI has a positive impact on levels of democracy in Latin America.**

Both parties involved in FDI expect their cooperation to be fruitful, as each supports neoliberal policies and economic liberalization (Biglaiser & McGauvran, 2018). However, market-led MNCs advocate for policies friendly to international investment in more leftist nations, forcibly exposing host economies to the world economy and democratizing, as seen in Simmons and Elkins (2004). Due to the potential disruption that market-led MNCs could have on moderate and liberal governments, market-led FDI may disrupt levels of democracy in leftist regimes.

Research from Carmody and Owusu (2007) and Shapiro et al. (2018) on foreign investment and influence in Latin America concludes that state-led FDI prefers consistency and stability over similar ideology in its recipient regimes. Ideologically conservative regimes may prefer to negotiate investment deals with state-led MNCs more often, but the final decisions of state-led MNCs are decided by the state. So, state-led MNCs are more concerned with advancing the state’s agenda than any ideological considerations. Since I argue in Hypothesis 2 that state-led FDI economically liberalizes and has no effect on political liberalization, I do not expect the introduction of ideology to significantly change the calculations of state-led investment. Therefore, I hypothesize that:
H4: The interaction between conservative ideology and state-led FDI has no impact on levels of democracy in Latin America.

State-led MNCs want to access “critical” commodities and to discover markets for state goods in their geopolitical and economic interests (Carmody & Owusu, 2007, pp. 506-507). The hypotheses regarding ideology are speculative and reduce ideology to a two-dimensional scale, because no current research investigates FDI’s ideological leanings.

In sum, I expect market-led and state-led MNCs to have quite different political and economic outcomes on recipient democracies, and I anticipate ideology to exacerbate these effects in the market-led case. Just as President Trump and the US are relatively content with Bolsonaro’s rise to power in Brazil, China and President Jinping are more concerned with economic implications and the future of their natural resource-laden relationship with Brazil. This study will test the effects of FDI on levels of democracy in Latin America to find notable trends and contemplate the future of FDI in the region.

Methodology

I employ a time-series, cross-sectional OLS regression with fixed effects to investigate the effects of US and Chinese FDI on levels of democracy in Latin America. US FDI serves as a proxy for market-led FDI due to its conformity with standardized FDI practices, while Chinese FDI exemplifies the tenets of state-led FDI. I use a time-series model to investigate the changes in my data over time, a cross-sectional model to generalize the results across each country in Latin America, and OLS because my dependent variable is continuous. I use robust standard errors clustered by country to account for serial autocorrelation in my dependent variable. These robust standard errors also account for any heteroskedasticity in the data. My model utilizes fixed effects to account for the unit effects of any individual datapoint on the model and avoid structural misspecification. I do not utilize a lagged dependent variable model in my analysis because my temporal range is limited to 2003 to 2012 and does not reach far enough back in time to measure dynamic causation. My sample includes Argentina, Barbados, Bolivia, Brazil, Chile, Colombia, Ecuador, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru, Uruguay, and Venezuela. Caribbean nations are included to supplement missing regional data in the model, as they share regional and cultural influences with Latin America. I choose my sample according to data availability in the United Nations Council on Trade and Development (UNCTAD) FDI database. I do not include any countries with more than half of their FDI values missing from 2003-2012.

Endogeneity is an inescapable problem associated with analyzing the effects of FDI and ideology on levels of democracy. A large portion of academic literature associates democracy with causing FDI, so I analyze this relationship in an alternate light. Other studies (de Soysa, 2003; Reuveny & Li, 2003; Sun, 2014) have investigated FDI’s effects on democracy, though my disaggregation of FDI by sender and host country substantially differs from these analyses. Information regarding the determinants of FDI and FDI’s effects on its host countries may only be found by looking at FDI’s relationship with democracy from a different angle. In accordance with previous studies (de Soysa, 2003; Reuveny & Li, 2003; Sun, 2014), I lag my independent variables in order to address simultaneity bias.
The dependent variables are measures of the Liberal Democracy Index, Electoral Democracy Index, and Participatory Democracy Index from the VDem dataset (version 9). Each measure ranges continuously from 0 to 1, with 0 exemplifying the least democratic and 1 the most; 0.5 is a close approximation to a 6 on Polity IV, signaling the onset of anocracy. Three measures of democracy are employed in my analysis to account for the differing levels of democracy throughout Latin America. The liberal democracy index tests the quality of individual and minority rights; these countries represent the strongest democracies, as they have consolidated their democratic institutions and promote independent judiciaries, minority enfranchisement, human rights, checks on the executive, and rule of law according to VDem’s Cppedge, et al. (2019). The electoral democracy index accounts for free and fair elections held within a country, as well as the responsiveness of rulers to citizens and independent media organizations. Lastly, the participatory democracy index measures the electoral participation of all people within a country. These indices gauge the different characteristics of democracy throughout Latin America and indicate how FDI affects different parts of democratic governments. Figure 1 displays the distributions of VDem’s Electoral, Liberal, and Participatory Democracy Indices in my sample.

![Figure 1: VDem Indices of Electoral, Liberal, and Participatory Democracies](image)

The independent variables in the model, Chinese FDI and US FDI, are logged in accordance with Li’s specifications (2009) to reduce the prevalence of outliers and normalize the data. I utilize net FDI outflows to indicate how the amount of FDI flowing into a country may impact its levels of democracy in the short term. These data are taken from the UNCTAD and are disaggregated FDI outflows from the US and China to each Latin American country measured in millions of US dollars. I code any FDI datapoints that range between $0 and $1 million as 0.1; these datapoints are included in the UNCTAD database and are not considered missing—though future scholars can specify these amounts and improve upon the precision of UNCTAD’s FDI database. I also code any negative FDI outflows as 0.05 to account for divestment flows while keeping my sample positive.

Ideology is another independent variable included in the model that solely serves as an interaction term with both Chinese and US FDI, estimating the exacerbated impact that ideology can have on FDI in each recipient country. This data was gathered from Baker and Greene (2011)’s compilation of Latin American ideology scores and follows their method when addressing missing data. Baker and Greene (2011) code the ideology data in a range from 0 to

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1 The averages of the Left, Center-Left, and Center-Right countries from the Wiesehomeier-Benoit index were used to substitute missing values for Barbados and Jamaica.
20, with 0 signifying an extremely liberal regime, 10 a moderate regime, and 20 an extremely conservative regime. These regimes are coded based on the winning president’s party and its ideological stances. Modern day Colombia and Brazil represent the most conservative regimes in Latin America, while Venezuela and Bolivia represent the most liberal regimes.

I include US FDI in the Chinese FDI models to control for competing FDI interests in Latin America, while I include Chinese FDI in the same manner for US FDI models. Controls for US and Chinese FDI from two years prior are also used as controls to account for the lingering effects of any previous FDI flows.

I include GDP per capita in the model as a control variable and take it from The World Bank in current US dollars. This variable controls for any effects that the recipient country’s economic success may have on Latin American levels of democracy while also addressing each country’s separate standard of living. A proxy variable for conflict is included to control for any further implications that internal strife may have on levels of democracy. These data were taken from the UCDP-PRI Armed Conflict and One-Sided Violence databases; any countries with deaths due to armed conflict or one-sided violence were coded as “1” in those respective years, while all others were coded as “0.” Lastly, a variable coding for natural resource rents as a percentage of GDP was taken from The World Bank to control for MNCs targeting certain countries for FDI due to their primary commodity reserves.

Results

Model 1 contains the results of the regression of US FDI and its interaction with ideology on the levels of liberal democracy, whereas Model 2 does the same for electoral democracy. In the same vein, Models 4 and 5 include the outcomes of similar regressions between Chinese FDI, ideology, and the levels of liberal and electoral democracy in Latin America. Models 3 and 6 display the results of regressing US and Chinese FDI on the levels of participatory democracy. Models 1 through 6 below contain coefficient data, standard errors, and level of significance.

In Models 1-6\(^2\), the interaction between ideology and both US and Chinese FDI exhibits a significant, slightly positive effect on the electoral and liberal levels of democracy in Latin America. Without accounting for the effect of ideology, individual FDI from both China and the US display negative effects on liberal and electoral levels of democracy in Latin America at the 0.05 level of significance. The results of Models 3 and 6 predicting FDI and ideology on participatory levels of democracy have no significance and no immediately apparent trends. Despite the differences between the US and China in terms of development, regime type, and FDI characteristics, each has the same effect on democratic development in Latin America.

\(^2\) These models were run again with lagged dependent variables as robustness checks and maintained the gist of their results, despite minor decreases in significance.
Table 2: Models of the Separate Effects of US and Chinese FDI on Levels of Liberal, Electoral, and Participatory Democracy

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<thead>
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<td>0.002**</td>
<td>0.003*</td>
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<td>0.313</td>
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<td>0.269</td>
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</tbody>
</table>

Note: Coefficients are reported. Robust standard errors are in parentheses. ***p≤.01; **p≤.05 *p≤.10  Bold results signify the main explanatory variables.

As an independent predictor, ideology is sparsely significant and shows a general positive effect. As countries become more conservative, their levels of democracy increase in Latin America. This may result from the more consolidated democracies in Latin America—such as Chile and Colombia—having more rightist governments during this time period or from the less consolidated countries in the region—such as Venezuela and Ecuador—having more leftist regimes.

Furthermore, the variables controlling for Chinese and US FDI lagged two years show no significance and little effect—other than US FDI (t-2), which has a slight negative effect on the levels of democracy in Latin America. Conflict as a control is negative and significant at the 0.01 level in Models 1 and 4 predicting ideology and US and Chinese FDI against liberal levels of democracy. As Latin American governments experience more conflict, they have decreased levels of democracy. The reason for conflict’s significance in the liberal democracy model is because this model takes rule of law and human rights into account; according to Coppedge et al., if a nation cannot procure rule of law, a monopoly on violence, and human rights protections...
within its jurisdiction, it scores much lower on the liberal democracy index (2019). GDP per capita as an additional control does not show any skew or significance in these models.

Lastly, natural resource reserves per GDP as a control shows significant, positive effects on liberal, electoral, and participatory levels of democracy in Latin America. As a nation has larger natural resource reserves as a portion of its GDP, its levels of democracy increase. In Models 2, 3, 5, and 6, natural resource reserves per GDP serves to highlight that it significantly predicts higher levels of electoral and participatory democracy due to the fact that these countries are wealthier due to their natural endowments and can afford to spend some of this greater income on democratic institutions and enfranchisement (Renard, 2011). The liberal democracy index does not display the same levels of significance, as it tests democratic consolidation more thoroughly—regimes with greater wealth concentrations in the primary sector must only be democratic enough to appease their constituencies and do not have to spread the resource wealth evenly (Biglaiser & McGauvran, 2018). This control does not overlap with GDP per capita, as the natural resource wealth is collected in the upper echelons of the economy and not distributed evenly, further exacerbating FDI’s negative effect on income inequality (Reuveny & Li, 2003).

Figure 2: Interaction Plots between US FDI and Ideology for Levels of Liberal and Electoral Democracy

Figure 2 displays the interaction plots between US FDI and differing ideologies for the liberal and electoral democracy indices with 95% confidence intervals when holding all control variables at their means. The red dotted line displays the mean for levels of liberal and electoral democracy in each of their respective plots. For both liberal and electoral levels of democracy, there is a slight negative impact from the interaction between US FDI and both the liberal and moderate ideologies. For the interaction between US FDI and conservative ideology, there is a positive effect on liberal and electoral levels of democracy. FDI is a boon to the democracies of more conservative governments. In a generic application of these results to bilateral relations

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3 Each interaction plot was also modelled with random effects, and these models with random effects showed the same patterns with wider confidence intervals.
between Brazil and the US, US MNCs are positively influencing the levels of liberal and electoral democracy in Brazil through FDI. Hypothesis 1 says that US FDI will have a positive effect on levels of democracy, thus the results of Models 1 and 2 do not support this hypothesis. US FDI has a significant and generally negative effect on democracy throughout Latin America. As US FDI increases, the host governments have lower levels of democracy. The exception to this pattern lies in Hypothesis 3, which describes the interaction between US FDI and conservative ideology as having a positive effect on levels of democracy. Models 1 and 2 support Hypothesis 3, showing that FDI from US MNCs have positive effects on the levels of democracy of more conservative regimes. As shown in Figure 2, US FDI has a strong, positive impact on the levels of democracy of more conservative states and a strong, negative impact on moderate and liberal states.

Figure 3: Interaction Plots between Chinese FDI and Ideology for Levels of Liberal and Electoral Democracy

In Figure 3 above, the interaction plots between Chinese FDI and ideology for the levels of liberal and electoral democracy with 95% confidence intervals and all control variables at their means show three trends. First, the interaction between Chinese FDI and liberal ideology has a strongly negative impact on levels of both liberal and electoral democracy in Latin America. Secondly, the interaction between Chinese FDI and moderate ideology has an insignificant positive effect on liberal and electoral levels of democracy. Finally, the interaction between Chinese FDI and conservative ideology has a strong, positive effect on levels of liberal and electoral democracies in Latin America. Interaction plots with the participatory democracy index are not included due to their lack of significance. In a similarly broad application of these results to the relationship between China and Brazil, Chinese FDI is positively affecting the levels of liberal and electoral democracy in Bolsonaro’s conservative Brazil.

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4 My temporal range does not include Bolsonaro’s rise to power, but the depicted trends apply generally to his conservative regime.
The results of Models 4 and 5 do not support Hypothesis 2, which states that Chinese FDI will have no effect on levels of democracy in Latin America. Conversely, Chinese FDI has a significant, negative impact on levels of democracy in Latin America. When Chinese FDI increases, the recipient government will have a lower level of democracy. Models 4 and 5 also refute Hypothesis 4, which argues that the interaction between conservative ideology and Chinese FDI will have no effect on democracy. Similar to US FDI, the impact of Chinese FDI on democracy is strong and positive when host governments are more moderate or conservative, as seen in Figure 3. When dealing with more liberal governments, Chinese FDI has a strong, negative impact on their levels of democracy.

When taking the interactions of both US FDI and ideology and Chinese FDI and ideology into consideration, Models 7-9 show that these two distinctive FDI patterns have similar results on democracy. Both interactions have weakly significant, positive effects on the levels of democracy in Latin America. Likewise, the results for US and Chinese FDI as predictors in the models are similar. US and Chinese FDI have significant, negative impacts on the liberal and electoral levels of democracy. Model 9, indicating the influence of Chinese and US FDI and their interaction with ideology on participatory levels of democracy, finds no significance in the predictors. US and Chinese FDI are acting in different manners and having the same effects on democracy in Latin America.

### Table 3: Models of the Effects of both US and Chinese FDI on Levels of Liberal, Electoral, and Participatory Democracy

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Ideology</td>
<td>0.002 (0.002)</td>
<td>0.001 (0.001)</td>
<td>0.002 (0.001)</td>
</tr>
<tr>
<td>Logged Chinese FDI</td>
<td>-0.007* (0.003)</td>
<td>-0.006* (0.004)</td>
<td>0.001 (0.003)</td>
</tr>
<tr>
<td>Logged US FDI</td>
<td>-0.004* (0.002)</td>
<td>-0.004** (0.000)</td>
<td>-0.001 (0.001)</td>
</tr>
<tr>
<td>Logged Chinese FDI</td>
<td>0.001* (0.000)</td>
<td>0.001* (0.000)</td>
<td>0.000 (0.000)</td>
</tr>
<tr>
<td>Logged US FDI</td>
<td>0.000 (0.000)</td>
<td>0.000* (0.000)</td>
<td>0.000 (0.000)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>0.000 (0.000)</td>
<td>0.000 (0.000)</td>
<td>0.000 (0.000)</td>
</tr>
<tr>
<td>Natural Resources/GDP</td>
<td>0.003 (0.001)</td>
<td>0.004** (0.002)</td>
<td>0.003*** (0.001)</td>
</tr>
<tr>
<td>Observations</td>
<td>113</td>
<td>113</td>
<td>113</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.02</td>
<td>0.0004</td>
<td>0.01</td>
</tr>
</tbody>
</table>

Note: Coefficients are reported. Robust standard errors are in parentheses.
***p≤.01; **p≤.05 *p≤.10 **Bold results signify the main explanatory variables.
When accounting for the control variables, Chinese and US FDI lagged for two years have insignificant, negative effects on levels of democracy. Conflict has a stronger negative impact on levels of democracy, explaining that Latin American nations with more intra-state conflict and violence have lower levels of democracy. GDP per capita has no impact on the model, and natural resource reserves per GDP display a similar effect as it had in Models 1-6. Natural resource reserves per GDP is a positive, significant predictor and displays that Latin American nations with larger natural resource reserves as a proportion to their GDPs will have higher levels of democracy.

Figure 4: Interaction Plots between US FDI and Ideology for Levels of Liberal and Electoral Democracy when including the interaction between Chinese FDI and Ideology in the model

As shown in Figure 4, the interaction plots between ideology and US FDI when taking the interaction between Chinese FDI and ideology into account exhibit similar trends to previous interaction plots. The interaction between US FDI and ideology has a slightly positive effect on the levels of liberal and electoral democracy of more conservative regimes while having a slightly negative effect on moderate and liberal regimes. However, the small slope and wide margin of error indicate that these results do not support any significant findings within the models with both interactions.
Likewise, Figure 5 displays the results of interaction plots between ideology and Chinese FDI when including the additional interaction between US FDI and ideology in the model. These interaction plots have similar results to those previously displayed, as the interaction between Chinese FDI and ideology has a negative impact on the levels of liberal and electoral democracy in more liberal governments and a positive impact on the democracies of moderate and more conservative governments. In reference to Brazil and China’s bilateral relationship, the interaction between ideology and Chinese FDI would positively influence Brazil’s levels of liberal and electoral democracy due to its conservative status and high levels of FDI inflows. However, like the former model with both interaction terms included, these models do not have the precision to confidently address trends within the data.

The results for the regression of Chinese and US FDI on levels of participatory democracy in Model 3 and 6 are negligible, and the interaction plots were not constructed. However, these results support the theoretical implications of this project. Chinese and US MNCs are investing into countries to procure resources, property guarantees, and profits; they are not investing in order to improve human rights records or minority enfranchisement. MNCs are more concerned with strong democratic institutions that ensure regime stability and future involvement in the region, thus reemphasizing the trend found throughout these models. Models 1, 2, 4, 5, 7, and 8 display the significance of Chinese and US FDI in affecting the liberal and electoral levels of democracy in Latin America, while Models 3, 6, and 9 show MNCs’ indifference towards the participatory nature of democratic regimes.

I find that both market-led and state-led FDI reinforce democratic regimes under more conservative governments; otherwise, they have a negative effect on levels of democracy in Latin America. These findings oppose three of my four hypotheses. As for the effects of market-led FDI and its ideological preferences for democracy, market-led MNCs have the power to invest in profitable markets and sustain said investments via democratic consolidation and stability. This effect is only present in conservative regimes, because conservative regimes serve MNCs’ interests. Market-led FDI harms democracy in liberal regimes in order to manufacture a
more suitable environment for international investment. State-led FDI and its ideological preferences for democracy are nearly identical to those of state-led FDI, except for the effects of state-led MNCs on moderate regimes. State-led FDI fuels economic activity that thrives under existing regimes and supports the continuance of its host regime’s ideology through its business. State-led FDI has a positive influence on regimes when paired with conservative ideology due to the propensity of conservative regimes to accept and encourage foreign investment. This argument applies to state-led MNC interactions with moderate regimes; however, the potential difference lies within the capacity of market-led and state-led MNCs to deal with the unfriendly policies of moderate regimes. State-led MNCs have state support, while market-led MNCs are largely on their own. Both market-led and state-led FDI discourage democracy in more liberal regimes due to restrictions on international investment. These results are theoretically unsurprising and call for greater investigation by the academic and policy communities as to prevent harmful influence on the developing democracies of Latin America.

**Discussion/Conclusion**

This study tests the effects of market-led and state-led FDI on the levels of democracy throughout Latin America. Ideology plays an important role in exacerbating the influences of market-led and state-led FDI on certain regimes and determining where FDI flows may help or hinder democracy. In the case of Brazil, China, and the US, Brazilian democracy is positively influenced by the flows of FDI into the economy, despite the differing geopolitical interests of China and the US in Latin America. President Bolsonaro could struggle against China’s influence in Latin America all he wanted, but he eventually acquiesced to China’s economic pull (Stuenkel, 2019).

I find through a time-series, cross-sectional OLS regression of state-led and market-led FDI on levels of liberal, electoral, and participatory democracy that market-led FDI generally harms levels of democracy throughout Latin America. More conservative governments experience a reinforcement of democracy by market-led investment, while the democracies of liberal and centrist governments are damaged by market-led investment. The same trend holds for state-led FDI’s effect on Latin American governments, although it has a more robust effect on each ideological type. These FDI influences witness changes in certain cases’ VDem scores by 0.1 points or greater, both lifting more conservative governments out of VDem’s threshold for anocracy and pushing more moderate and liberal governments towards anocracy. The lack of influence of market-led and state-led FDI on participatory democracies supports my theoretical arguments; MNCs do not concern themselves over the enfranchisement of minority groups in Latin America—instead they fret over the strength of democratic institutions and rule of law.

This study analyzes FDI literature under a different light, investigating FDI’s influence on levels of democracy throughout Latin America. Furthermore, it takes the ideology of recipient governments into consideration and predicts how certain ideological leanings exacerbate the effects of market-led and state-led FDI. These results reinforce and expand upon the findings of Gholipour Fereidouni et al. (2011) which found that FDI has no effect on the levels of political speech and accountability in the Middle East and North Africa. Latin America—with more consolidated democracies and stronger economies—deepens the implications of Gholipour Fereidouni et al. (2011) by displaying FDI’s consistently negative effects on the region. However, a wrinkle emerges in the interaction between ideology and state-led or market-led
FDI. Both of these interactions have statistically significant, positive influences on levels of democracy throughout Latin America, suggesting that FDI may cultivate democratic consolidation in regimes that will foster further investment.

Future studies should analyze the effects of other FDI sources—ranging from consolidated democracies such as Germany, Japan, and the United Kingdom, to less democratic regimes like Turkey, Russia, and Saudi Arabia—on the levels of democracy in developing regions such as the Middle East, Latin America, South Asia, or Eastern Europe. The FDI methods of these countries should be classified as market-led or state-led and examined in greater detail. Viable disaggregated FDI data also needs to be expanded, as useful UNCTAD data only ranges from 2003-2012 and few modern alternatives exist. Natural resources played a significant role as a control in the model, presenting another topic for future FDI research on the determinants of FDI. Lastly, ideology’s impact on the draw of FDI to certain countries should be studied in greater detail. If MNCs are mainly interested in more conservative governments, they will have undue influence on regional politics and pave the way for easier operations in developing primary sectors. Scholars should work to identify proponents of both state-led and market-led FDI in order to mitigate their influence on governments, resource extraction, and labor practices.
References:


