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THE RELATIONSHIP BETWEEN POLITICAL REGIMES AND FOREIGN DIRECT INVESTMENT

Bachelor’s Thesis

Programme International Relations

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Tallinn 2017

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ABSTRACT

The aim of this paper is to examine the relationship between foreign direct investment and regime type more closely. The principal research questions of this paper are – Do democratic states attract more FDI, or does FDI prefer non-democratic regimes? What are the leading arguments and theories on the subject matter, how do they contradict each other and why? The review of the secondary sources shows that the existing theoretical and empirical discussion is inconclusive, because it fails to account for unique spatial and temporal details, rendering the theories mere generalizations. To offer a more appropriate method, the paper applies a most-similar case design to a comparison of China and India in terms of how they attract and foster FDI. The sources used in the case study include official government sources of India and China and international databases. The key finding of this paper is that what matters more for FDI is policy instead of polity. Authoritarian or democratic regimes may utilize different policies to attract and foster FDI, and the implementation of said policies is what matters. Existing theoretical and empirical literature may provide useful suggestions; however, the findings of this paper challenge the idea that the relationship between FDI and regime type is clear-cut.

Keywords: Foreign Direct Investment, Multinational Corporations, China, India

INTRODUCTION

There is an idea especially in the western world that democracy is a good way to organize a polity. Democratic practices ensure that the electorate may freely partake in political decision-making, for instance through voting or running in elections. Furthermore, separation of powers and civil liberties, at least in theory, ensure accountability and transparency of the system. The concept of Good Governance was coined by international institutions, such as the United Nations (UN, 2009), and it essentially advocates liberal democratic practices to be applied across nations to ensure the effectiveness and fairness of political institutions. On the other hand, Good Governance has also been linked with economic development – the International Monetary Fund (IMF) loan conditionality includes Good Governance clauses, namely "ensuring the rule of law, improving the efficiency and accountability of the public sector and tackling corruption" (IMF, 2005). Hence, there is a conception that democracy makes countries prosper not only politically but also economically.

However, these claims are challenged by looking at real life examples such as China. It is an authoritarian one party system whose institutions and decision-making lack transparency, while civil liberties are limited. Yet the country has been able to sustain phenomenal economic growth ever since it started to open up to the global economy in the 70's. The Chinese experience challenges the idea that democracy would best provide conditions in which economies develop and prosper. This contradiction is of profound importance especially for developing countries that are formulating policies on how to best achieve growth.

Theories and international institutions support the idea that foreign direct investment (FDI) is a key component of economic development (UNCTAD, 1999). The importance of FDI for developed and developing countries alike is apparent in the way that many countries implement FDI friendly policies, while competition for it has been fierce. The question then becomes, what is the relationship between FDI and democracy? Do democratic regimes also provide for the best possible conditions for foreign investment? The answer to this question is not that straight forward, when one consults the theories and empirics relating to the issue.

Some theories posit that foreign investors are attracted to democracies because they have independent and strong judiciaries which help to secure property rights, which in turn promote investments (Olson, 1993, 572). Furthermore, the checks and balances of democratic regimes provide for accountability and transparency, which convince investors of a stable investment climate (Jensen, 2006, 81). These arguments seem logically sound, yet competing theories argue that authoritarian regimes can provide for an equally attractive investment climate. For instance, it is in the interest of the MNCs to have a monopolistic position in the markets to secure a higher rate of returns. This imperfect market position can be offered by authoritarian states, because there is a lack of checks and balances and accountability to the electorate (O'Neal, 1994, 582). Furthermore, the lack of checks and balances may enable the states to organize institutions and policies flexibly and quickly to support MNCs and their long-term investments. In addition to the vast theoretical discussion, multiple empirical studies have been conducted to pin down the correlation between FDI and regime type, only to provide equally inconclusive findings.

Given that the existing theoretical and empirical discussion is inconclusive, the objective of this paper is to examine the relationship between FDI and regime type more closely. The principal research questions of this paper are – Do democratic states attract more FDI, or does FDI prefer non-democratic regimes? What are the leading arguments and theories on the subject matter, how do they contradict each other and why? Is there a more appropriate method to study and understand the relationship between FDI and regime type?

This paper is a part of a larger research project conducted by the author, which in addition to the findings discussed here, concludes through a methodological critique, that the theoretical and empirical studies on the subject matter suffer from serious shortcomings. The empirical studies struggle with data accuracy and controlling for the dependent and independent variables. Furthermore, there are issues with the conceptualizations made regarding the core concepts. Democracy has been conceptualised through thin and thick definitions. Thin definitions argue that there are less attributes that need to be reached to deem a regime democratic, whereas a thick definition requires more categories to be fulfilled. Depending on whether the utilised definition is a thin or a thick one, it may sway the theorists' study and thus also the results greatly.

Additionally, the existing theories have largely overlooked the historical changes in relation to how MNCs operate. Dörrenbächer and Geppert summarise these changes by stating: "Taking a post-millennium perspective, tremendous changes in the world of the MNCs become visible.

Changes extend to the socio-political and economic environment of the MNCs, the types of MNCs either entering or dominating the scene as well as the mode by which these companies operate." (2017, 5-6). MNCs' goals and objectives as well as how they operate evolve constantly, and thus the preferences for the host country policy atmosphere must be in a similar flux. Most theories fail to account for said changes, empirical models by compiling data over decades and not accounting for the changing objectives and preferences, and theories by making the assumption that MNCs operate in a uniform way.

The structure of this paper is such that in the first two sections, the relevant theories and empirical models will be analyzed. The literature review provides an overview of the main arguments and reveals the inconclusiveness of the discussion. Resulting from the extensive criticism conducted on the theoretical and empirical literature in the framework of the wider research project, this paper proposes an alternative way to study the relationship. To offer a more appropriate method, the third section of this paper applies a most-similar case design to a comparison of China and India in terms of how they attract and foster FDI. A most-similar case design is applicable, because the countries have attributes which foreign investors find attractive, including large market size and rapid economic development. However, China is a socialist regime with authoritarian characteristics, whereas India maintains a liberal democracy. The case study conducted on these two countries provides for interesting results, that point to the fact that political regime is not perhaps the most important issue to consider in what comes to the relationship between FDI and states. Finally, the last part of the paper concludes and advances some suggestions for further research. The sources used in this paper include theoretical and empirical secondary sources, official government sources of India and China and international databases, such as those of the World Bank, Freedom House and the United Nations.

The key argument in this paper is that the theoretical and empirical literature is trying to portray a complex relationship in too simplistic terms. Therefore, what should be done instead is to individually study each regime and the FDI it attracts, accounting for the unique historical, economic and political characteristics. When this method is used to analyze the relationship, it should not come as a surprise that there can be no straightforward answer to the question of how the political regimes affect investment decisions.

The key finding of this paper is that what matters most for FDI is policy instead of polity. Authoritarian or democratic regimes can utilize a range of policies to attract and foster FDI, and the implementation of said policies is what matters. Since there is questionable correlation between policy and regime type, it is thus not surprising that a clear correlation between FDI and regime type does not exist. This finding emerged from the most-similar case design comparison conducted of China and India. Both states utilize a range of different policies to attract FDI, and in the end their implementation has been more successful in China, a regime that happens to be characterized by authoritarian elements. In some other case, perhaps a democratic regime has been more successful in implementing policies to attract FDI. What follows from this finding is that one should not make assumptions based on regime type alone, but thorough research needs to be conducted to identify how the policies are implemented and constrained in the unique political environment of the state. The findings of this paper add to the existing literature by challenging the theoretical and empirical models which for decades have attempted to find clear-cut answers to the question of how the regime type affects foreign investment decisions.

1. THEORETHICAL APPROACHES TO THE RELATIONSHIP BETWEEN REGIMES AND FOREIGN DIRECT INVESTMENT

One of the driving forces behind the globalized economy is the significant increase in FDI. FDI, as defined by the OECD Benchmark Definition "…reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise" (OECD, 2008, 46). The difference of FDI and Foreign Portfolio Investments (FPI), is that a FDI investor has active control over the enterprise, it is a long-term investment and less liquid than FPI.

According to the World Bank (WB), FDI has increased from over ten billion dollars in the 1970's, up to $1.7 trillion in 2016 (World Bank, 2016a). Most FDI is directed towards the more developed countries. The European Union attracts the most, second being the United States and the United Kingdom being third (Central Intelligence Agency, 2017b). On the other hand, developing economies comprise half of the top ten economies to which FDI is directed (UNCTAD, 2017a, 12). Figure 1 illustrates the global inflows of FDI to countries grouped according to their level of development, from 2005 to 2016.

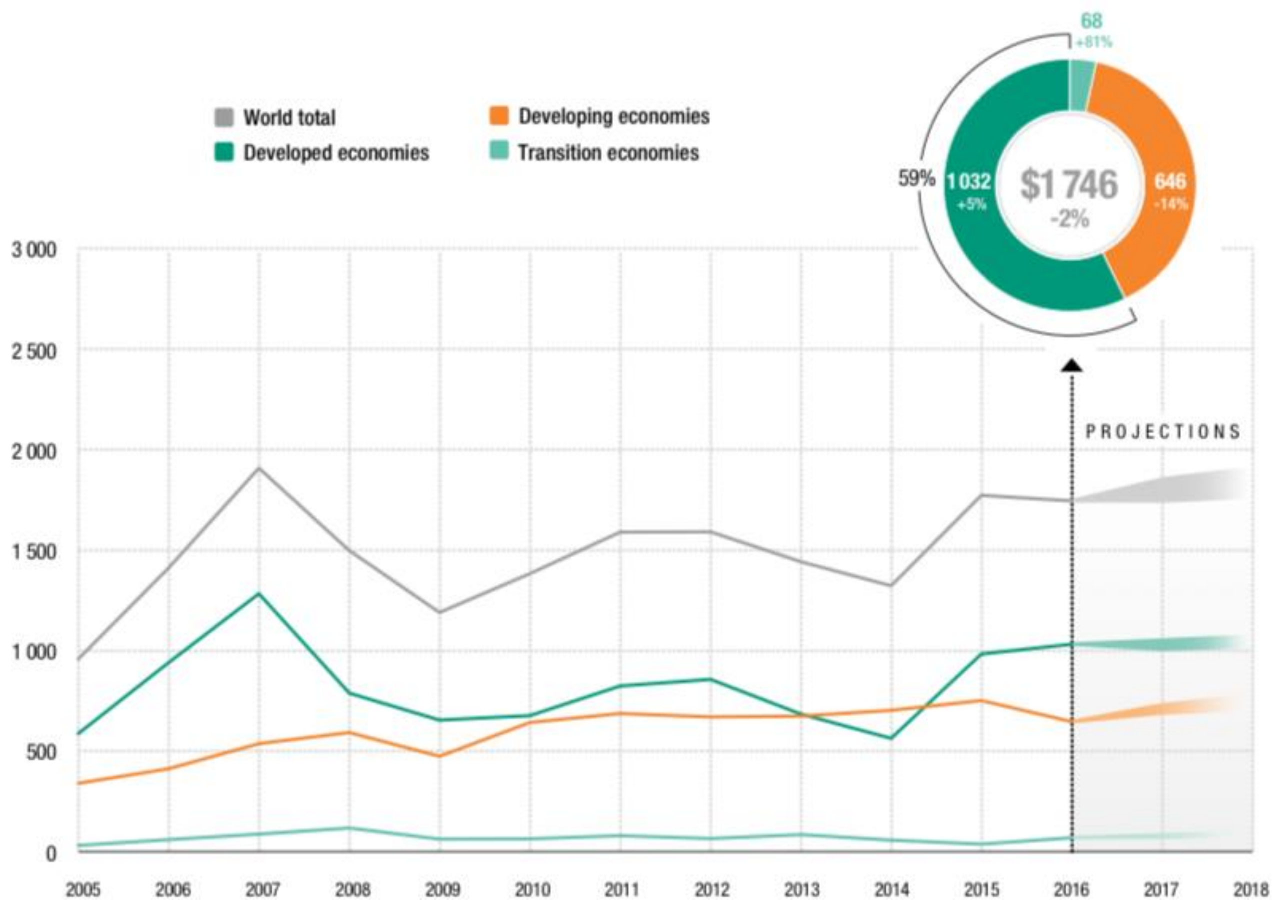

Figure 1. Global inflows of FDI by group

Source: UNCTAD (2017a, 2)

1.1 The Motivations for Multinational Corporations to Engage in Foreign Direct Investment

There is a fair degree of consensus amongst scholars, that the general motive for Multinational Corporations (MNCs) to engage in FDI is to gain profit. Dunning and Lundan's (2008, 67-73) arguments are often cited in the relevant literature to describe these motivations. The four main drivers are natural resource seeking, market seeking, efficiency seeking and strategic asset or capability seeking. The natural resource seekers, as per their name, seek resources which may not be available anywhere else. This type of investment is known as vertical FDI. Secondly, the market seekers want to establish themselves locally because of the country's market size or for instance tariff jumping. Furthermore, at times a company needs a local presence to be able to compete with the domestic companies. This type of FDI is known as horizontal FDI.

Thirdly, the efficiency seekers want benefits, which result in their production activities being geographically dispersed – the benefits include for instance economies of scale. Companies might be interested in organizing some of their production in a specific country due to it being labor abundant, and some of the production would take place in more developed countries which would give support in terms of capital, technology or information. Finally, the strategic asset seekers choose to invest in a specific location to further their global foothold and competitiveness. The efficiency seekers are usually larger MNCs, which have a global presence and enjoy the benefits brought by experience and knowledge, which help them organize their activities efficiently and to fight off competition.

The objective of this paper is not to discuss in depth why FDI takes place, but to concentrate on the factors that affect its direction. To what extent is FDI affected by the political regime in the host country? Does a democracy make FDI more profitable, and if so, how? Let us imagine that a MNC has a few prospective countries to choose from. There are various points to consider as to how the most favorable conditions are met to attract FDI. In the following sections, those conditions will be discussed in terms of how they interact with democracy and non-democracy. Specifically, the relationship will be analyzed from the perspective of how well different regimes help support favorable conditions. These conditions are – stability, representation of interests and credibility of the institutions. These points were chosen for analysis because they are the key elements which recur in the theoretical and empirical discussions.

One may argue that MNCs in search of natural resources or large markets might not be interested in the host country's political environment, because the benefits of gaining the resources or entering large markets override possible negative effects of a specific political regime. However, the country's ability to provide a safe and stable environment for FDI is crucial, as the investments become vulnerable after is has been made. There are considerable sunk costs involved in FDI due to its illiquid nature. In the worst case, the host country may renege on the contracts after the deals have been made and to avoid this, MNCs logically would prefer to invest in a secure climate. Would a democratic state provide stability and secure investments more efficiently in comparison to a non-democratic one?

The credibility of the state is an important factor to consider for MNCs making investment decisions. Companies might not even approach countries that they deem lacking in credibility. The credibility in part also deals with stability and security of investments, since policy reversals might

not seem an issue if the country has a credible outlook. Hence the question in relation to the scope of this paper becomes – which type of regime is more capable of appearing credible to MNCs?

Representation of interests relates to the discussion in the way that MNCs logically would like to have a say in the policies of the recipient country. MNCs want to negotiate preferential investment deals, but they would also be interested in affecting the climate in the recipient country after the deals have been struck, to protect investments in the long-run. Representation of different actors' interests may be facilitated differently within democracies and non-democracies, the former providing many channels for participation, while the latter being more selective. What is the level of representation which would seem more attractive to the MNCs? Would the companies prefer a democracy, which is more open but where they would have to fight many competing voices, or would they prefer a non-democratic system, in which they might have a possibility to collude with the government while competing voices are suppressed?

1.2 Why would Democracy Foster Foreign Direct Investment?

1.2.1 The Profitability of Foreign Direct Investment under Different Political Regimes

The liberal school argues that individuals have a natural right to the fruits of their labor. Locke argued in the 17th century that with the right to property also comes great uncertainty and fear of thieving. The fear of others plundering one's property drives people to form societies to protect themselves. This view in more recent years has been repeated by Olson (1993), when he argues that citizens of a state are willing to give part of their income to a *stationary bandit*, who has a "monopoly on theft in his domain" (Olson, 1993, 568). The monopoly of theft would relate to taxation of the people by the authorities, in exchange for the desired peace, which protects peoples' property. When people feel that their property is safe from thieving, they will produce more because of the possibility to profit from their labour.

Secure property rights are of paramount interest to MNCs. Before an investment is made, the company holds bargaining power because they have many alternatives. After the investment has been made, however, there are sunk costs involved in the projects, as they are often made in illiquid assets, such new factories. It is much more difficult and costly for a company to relocate afterwards if the host state reneges on the contracts or proves to be in some other way opportunistic regarding the investment. This process has been coined "obsolescing bargain" by Vernon (1971). One of the

seminal theories relating to property rights protection, by North and Weingast (1989; 803), argues that to achieve economic growth and attract investment, states need to provide institutional support for property rights protection and most importantly, commit and not renege on the contracts. For our discussion, one could ask: Does democracy as a political system provide a safer environment for FDI against obsolescing bargaining? In the next section, the stability aspect of democracy is discussed.

1.2.2 Democracies offer Stability and Credibility for the Foreign Direct Investments

Defining democracy is a task for a separate paper, however in rudimentary terms it is a system characterised by procedures and institutions that offer citizens the possibility to express their wishes in terms of whom they want to lead them and how. There is a rotation of people in power due to the electoral processes, transparent institutions and separation of power between governmental bodies and the judiciary provide checks and balances, accountability and stability. To avoid obsolescing bargain, democracies provide stability for investments through impartial court system. It protects individuals' right to property, not only against violations by other individuals but neither can the government relapse on its contracts and promises because it is constrained by the law as well.

To be able to inspire confidence in MNCs, the recipient state needs to appear stable enough to provide protection for the investments in the long term. Jensen (2006) further argues that democracies' creditability is enhanced by the audience cost, according to which "…if governments make agreements with multi-national firms and renege on the contracts after the investment has been made, democratic leaders may suffer electoral costs. The potential for these electoral backlashes may constrain democratic leaders." (Jensen, 2006, 81) Through electoral cycles, politicians who are responsible for generating unsuccessful policies may be removed and replaced by others who would make more market-friendly decisions. Therefore, the politicians are constrained from turning opportunistic, as this might lead them to lose office.

On the other hand, in authoritarian regimes in which power is not dispersed, the state might relapse on its promises or contacts, since they can do so without having to answer to a judiciary. The intrinsic instability of an authoritarian regime, as argued by Olson (1993), does not only affect the decisions made by the MNCs, as the ones in power of the state might behave short-sightedly because of the instable conditions (Olson, 1993, 571). Authoritarian regimes can face domestic or

foreign threats because of lack of consolidated power, and may only be interested in maximising personal gain for the power elite. The ones in power may not even be interested in providing stable long-term investment conditions in their country, if they do not see their regime surviving. In theory, those in power in authoritarian regimes are only accountable to the power elite, and would thus logically only serve the interests of the elite. Theoretically in democracies it would not be possible to have a ruling elite, which does not respect the wishes of the populace and is there to only serve itself.

1.2.3 Representation of Interests, Openness and Transparency in Democratic Regimes

In democracies citizens enjoy civil liberties. These liberties include freedom of association, press and speech and the opportunity to take part in, influence and pressure the political process through multiple channels. These channels include voting and running in elections, being part of interest groups or lobbyists, organising strikes and so forth. How this relates to MNCs is that they have the same right to take part in the political decision-making process. Investors may utilise direct or indirect political avenues to influence the democratic host countries to pursue policies which would help foster their investments. The effectiveness of MNCs' efforts will depend on the political influence they wield, in comparison to competing voices.

For any actor that wishes to influence the policies of a country, understanding of the political process and situation is vital. To bring about a change, one needs to comprehend the political culture and foresee possible future developments. To have the comprehension and expertise required, there needs to be transparency. Jensen (2006; 79) points out that the transparency which characterises democracies will encourage companies' decisions to invest. There is transparency in the decision-making process as well as the decisions which have been made. The transparency would lead one to deduce that there is accurate information available regarding the macroeconomic environment and how the government operates. This helps investors to react to future government policies as well as to formulate their lobbying schemes.

1.3 How would an Authoritarian Regime Foster Foreign Direct Investment

1.3.1 Authoritarian States Offering Credible Stability for Foreign Direct Investments

The previous section argued that democratic states, because of their checks and balances and impartial judiciary systems, offer a stable investment climate for MNCs. However, another set of attributes may be found in authoritarian regimes, which could provide a stable climate for foreign investments and promise profitability. After all, FDI does not only flow to democratic states, but also to non-democratic and transition regimes. This is apparent in the fact that China and the Russian Federation are amongst the top ten recipient countries of FDI inflows in 2016 (UNCTAD, 2017a, 12). These states can be characterised as lacking in democratic merit, pointing to the fact that they must offer credible stability somehow.

The theoretical literature argues that authoritarian regimes may choose to exploit their position of high control to foster FDI. According to O'Donnell (1978), an authoritarian state can provide a stable long-term investment climate by exerting strict and continuous control over civil society and economic policy, hampering domestic actors' ability to partake in decision-making. To support his argument, he argues that this has been the case in 1960's in several Latin American countries. He calls these states "bureaucratic-authoritarian" (BA) states (1978, 4). According to this line of thinking, if an authoritarian state wished to do so, it could commit to policies which favour foreign investments. However, as a counter reaction, it would repress domestic economic and political opportunities by excluding actors like labour unions from political and economic decision-making. This type of setting would indicate there is collusion between the power elite of the country and the MNC.

If one assumes that MNCs are only interested in maximising their profits, it would make sense that a collusion with a state would seem highly attractive. The company would be in a position in which it could affect the economic policies without having to face domestic competition. This type of collusion would not be sustainable in democracies, since through elections the ones in power would be removed by the discontented electorate. In democracies, those in power are forced to find a balance of sorts to please the domestic electorate while still reaping benefits from lucrative foreign investments.

To achieve a state of collusion with investors and to convince them of the regime's longevity, the authoritarian state needs to appear credible. authoritarian states cannot enjoy similar credibility to that of a democratic one, because it concentrates power in the hands of the elite, instead of dispersing it amongst multiple institutions. Some theories provide an answer to this dilemma. For instance, O'Donnell (1978, 6) argues, that the very foundation of the BA is giving it the requisite creditability. The higher positions of power are filled with people who come from a background of bureaucratic institutions, for instance the armed forces or successful private firms. The leadership of the country seems competent and this would in turn spark confidence in the eyes of the foreign investors.

Furthermore, it can be argued that autocratic states are able to lengthen their horizons to attract the long-term investments. The fact that there are no checks and balances on the power of the elite, may prove to be an advantage. The ones in power can flexibly and quickly establish new institutions to support long-term investments, for instance institutions which would secure property rights. While establishing such institutions could restrain the power of the autocratic elite, the regime would seem more stable and credible. It may be asked why an autocratic country would decide to redistribute power, and risk the elite's power within the state? Moon (2015, 353) argues that autocratic states realise the benefits of giving protection to long-term investments, because they yield more profit in the long term. Hence, they will not relapse into predatory behaviour and expropriate. The possibility of gaining from long-term investments works as an incentive to the power elite.

1.3.2 The Incentives for Multinational Corporations to Collude with Authoritarian States

In the beginning of the paper it was discussed that MNCs engage in FDI for instance due to strategic reasons (Dunning and Lundan, 2008, 73). These MNCs were recognised to be usually of large size and of a high level of competitiveness. It would thus make sense, especially for those companies who possess a lot of market power, to try and establish a strategic monopoly position in the recipient country, to yield more revenue. Li And Resnick (2003) go so far as to argue that "… the weaker the host country's democratic institutions, the less likely the host government is to limit the monopoly or oligopoly position of the MNCs" (2003, 183).

In addition to letting companies exploit monopolistic positions, an authoritarian regime could also provide MNCs with financial incentives, for instance tax breaks. While the incentives will seem favourable to the MNCs, they may hurt domestic actors, for instance by being driven out of the markets because they cannot compete with the subsidised or oligopolistic foreign ventures. In effect, the selective incentives would lead to a two-tier economy, where MNCs are the winners and domestic actors the losers. Li and Resnick argue that "… Compared with more autocratic countries, more democratic host governments have a harder time obtaining the acquiescence of opposing domestic interests to the provision of generous incentives to foreign capital" (2003, 184). They seem to argue that the authoritarian regime can do things which the democratic one could not. In this line of thinking, the very features that made democratic regimes attractive to MNCs – checks and balances, impartial courts and recurring elections – would lead the country into having fewer tools to attract FDI.

1.3.3 Representation of Interests and Transparency in Authoritarian Regimes

Representation of interests in a democracy was argued to be of benefit also to the MNCs, since amongst other actors, they could utilise lobbying schemes to influence policies, or try to influence the policy makers, for instance by mobilising their workforce. However, this argument can be looked at from a different perspectiv. The fact that there are many actors within a democratic state who can influence the political process, may prove to be a hindrance to the MNCs' efforts. The MNCs' power to influence political decisions is diluted and challenged by domestic actors, and it is largely up to the state to choose which actors to listen to. Li and Resnick (2003) point out that more often than not, domestic actors' goals contrast the MNCs' preferred goals concerning financial and economic policy, forcing the government to "cushion the blow to domestic losers by subsidizing less competitive indigenous firms, imposing more restrictive entry conditions on MNCs such as joint ownership, limiting the sectors open to foreign capital...". (2003, 183) This in turn could lead to reducing the "MNC's degree of control over its overseas production and weaken its competitiveness" (Li and Resnick, 2003, 183).

Lobbying through political channels is a legal way to influence the policy-making process, however one should not overlook the fact that there are illegal ways for MNCs to influence policymakers, like bribery. Due to the freedom of expression and uncensored media in democracies, there is a watchdog on the government which monitors the officials. Corrupt acts may be called out in the media, after which the perpetrators would have to face consequences, for

instance renouncement of position. On the other hand, in authoritarian countries the ones in power practically answer only to themselves and have control over the civil society and media, therefore MNCs have an opportunity to use illegal means of influence.

2. EMPIRICAL APPROACHES TO THE RELATIONSHIP BETWEEN REGIMES AND FOREIGN DIRECT INVESTMENT

The theoretical discussion of the relationship between FDI and regime type is inconclusive to say the least. The theories give weight to different arguments and offer logical conclusions whether one or the other type of regime is more attractive for MNCs. It is fair to see that there are negative and positive effects which democracy or non-democracy may impose on FDI, but without empirical studies, one cannot say for sure which overpowers the other. Hence, this paper will turn to look at the empirical literature which has been conducted to find correlations between regime types and FDI. This part of the paper is organized so that first the negative correlations found between democracy and FDI will be discussed, followed by the positive correlations. Much like in the theoretical review, it will become apparent that the empirical studies are equally contradictory and have a difficult time in pinning down comprehensive answers to our research questions.

2.1 Negative Correlation Between Foreign Direct Investment and Democracy

2.1.1 Empirical Evidence that There is Greater Rate of Return for Investments in Authoritarian Countries

One of the earliest and most recognized quantitative works dealing with our subject matter is O'Neal's (1994) regression analysis of 48 different countries at different levels of development, covering the years from 1950 to 1985. The study is interesting because it takes O'Donnell's theory of the BA, and tries to see whether it would hold. O'Donnell's theory entailed that foreign companies are attracted to authoritarian regimes, because of the possibility of exploitation of monopolistic positions and financial incentives in the host countries, which would yield them higher returns than in democratic states.

O'Neal's (1994, 571-582) study looks at the amount of FDI that has been directed from the U.S. to the sample countries, while taking into consideration the whole of FDI which the U.S. gives in a year. The second variable he studied was the profitability from these investments, while accounting for global business cycles and trends. Through the analysis, it became apparent that the flow of investments has been higher to democratic countries but the relationship is not significant.

On the other hand, the profitability of the investments has been higher in authoritarian regimes. The results of the empirical study go to show that according to this data, specific time span and selected countries, regime type is insignificant.

O'Neal's empirical analysis seems to provide a general answer to the question whether regime type influences the rate of returns. On the other hand, later studies have provided more insight to the complex relationship. Davis and Shomade's (2005) empirical analysis indicates that as democratization first happens in a country, the returns are much higher for MNCs, however through time after the country becomes more democratic, the rate diminishes and becomes negative (2005, 19). The change in the profitability may be explainable by the fact that as countries democratize, new regulations are introduced which raise costs for the firms. This empirical study, in addition to O'Neal's, indicate that autocracies or states in early stages of democracy could be more attractive, at least profit wise.

2.1.2 Empirical Evidence that Suggest the Relationship Between Foreign Direct Investment and Democracy is Ambiguous

Some empirical studies have taken as a starting point the fact that there is no consensus amongst the theories about the relationship between FDI and political regimes and ambiguous results are to be expected. Li and Resnick (2003, 188) built their quantitative study on 53 developing countries, from 1982 to 1995. Their hypothesis was that democracy affects FDI in complex ways, but the negative effects overrule the positive ones. The thesis proved to be right as the results showed that FDI inflows increase with higher levels of democracy because it would also mean a higher level of property rights protection. However, after controlling the effect of the property rights aspect, democracy had a negative correlation with FDI (Li & Resnick, 2003, 203). This finding supports the idea that given that authoritarian regimes provide for property protection, they are may be attractive to MNCs as well.

Li and Resnick studied developing countries specifically. From their findings one may deduce that amongst developing countries, the authoritarian regimes have an advantage in terms of attracting more FDI. Jessup (1999) supported this argument, as according to his empirical findings democratic countries have been losing market share, and developing authoritarian states have been receiving more U.S. investments in the past few decades (Jessup, 1999, 20). From these empirical models one may deduct, given that the authoritarian countries attract more FDI in comparison to the more democratic ones, they may also have an opportunity to develop at a brisker pace. Of

course, this logic will hold only if there exists a positive correlation between the level of FDI and economic growth. Recent empirical models have indeed recognized a positive correlation between the two (Alfaro et al., 2004). If democracies and hence also less developed democracies are gaining less FDI, there might be an incentive on their part to turn to authoritarian practices to compete for FDI.

2.2 Positive Correlation between Foreign Direct Investment and Democracy

2.2.1 Empirical Evidence Suggesting More Foreign Direct Investments is Directed to Democracies Because of the Preference of the Electorate

Jakobsen and De Soysa (2006, 384) argue in their empirical model that democracies are more attractive for MNCs to invest in, because the electorate is actively trying to attract FDI. The argument follows the same logic regarding free trade (e.g. Milner and Kubota, 2005). Free trade takes place between democratic countries, because the majority of the electorate prefers it. Hence, as majority of the electorate in a democracy prefers FDI activities, the MNCs are encouraged to invest and they are provided with a supportive climate in the host economy. According to this logic, the empirical results should reveal a higher level of FDI in democracies.

Jakobsen and De Soysa (2006) repeated a similar empirical model to that of Li and Resnick's, who concluded that democracy has a significant negative correlation with the level of FDI. The novelty of Jakobsen and De Soysa study is that they increased the sample by 46 countries and expanded the time period up to 2001. They argue that there are serious shortcomings in the Li & Resnick study, and that it was skewed by sample bias and weak variables. The results of the Jakobsen and De Soysa study supported their thesis – there was a positive and significant correlation between democratic developing countries and FDI. They claim that in contrast to the argument of Li and Resnick, that MNCs would "punish democracies", democracies instead inherently welcome it because the populace prefers it (Jakobsen & De Soysa, 2006, 404). This specific theory shines some light to the difficulties related to econometric studies in general – sample bias and size may very easily affect the results and skew them.

2.2.2 Empirical Evidence Suggesting Incentives are Not a Main Concern for Multinational Enterprises

Earlier in this paper, financial and fiscal incentives were recognised to be a policy more readily available to autocracies due to there being fewer veto-players and the ruling elite may only be pressured by the markets and not by the electorate. Jensen (2006) based his quantitative study on the point of view that the incentives have largely been overemphasised and that the race to the bottom with the help of the incentives has become a cliché without actual merit to it (Jensen, 2006, 54). His study revealed that there is little evidence that a country's fiscal policy would influence the level of FDI (Jensen, 2006, 67). Jensen provided further evidence to corroborate his findings – he interviewed MNCs, tax consultants and investment promotion officials whether fiscal incentives are amongst the primary determinants when decisions are made regarding investment locations. The interviewees did not deem incentives to be amongst the important determinants for the decisions (Jensen, 2006, 69).

In practice, the financial incentives could take the form of low wages in the host country. The theoretical argument goes that MNCs would be attracted to locations with low wages because it improves the profitability of their investments. It is however questionable whether the MNCs would only be interested in maximising profits. Where O'Neal and Davis & Shomade found that profitability is greater in authoritarian regimes, other quantitative studies have shown that it is not a primary interest for the investors. Graham (2000) studied the relationship between the level of income in host countries of FDI and the amount of U.S. investment in the late 90's and early 00's, to conclude that the investments were not systematically directed towards low-income countries, but rather to rich countries where the cost of labour was same, or in some cases, even higher than in the U.S. (Graham, 2000, 112). These findings challenge the argument that the prospect of saving on costs would primarily drive investment decisions, which also implies that authoritarian countries would not be especially competitive to MNCs, given they would employ these tactics.

3. CASE STUDY OF CHINA AND INDIA

In this chapter, a comparative case study will be conducted of China and India. The two countries can provide interesting results for our subject matter. China is a socialist regime with authoritarian characteristics, whereas India maintains a liberal democracy, being the largest of its kind in the world. The case study should reveal how the theories and empirical findings of scholars would apply to the two politically contrasting states. The comparison enquires about how these states provide stability to protect private property rights, how credible they seem, what the level of representation of interests is, and finally, what incentives they provide taking into consideration their respective political institutions and capabilities. The novelty of the case study lies in the fact that it will fill some of the gaps in the existing literature. There is a high degree of temporal and spatial sensitivity to the relationship between FDI and political regimes and this was largely dismissed in most studies since they often tried to provide a general theory. Hence, the case study will look more closely at the development of FDI in each country, the preferences of different kinds of MNCs and the perception the state itself has of FDI.

There are a few factors which make the two countries appropriate to be contrasted in a case study. China and India are amongst the first countries which come to mind when one thinks of large markets. They are geographic, demographic and economic giants. By GDP, China is the world's second largest economy and India the seventh largest (World Bank, 2016b). By population, China is the largest and India a close second (Central Intelligence Agency, 2017a). Hence, both countries can certainly seem attractive to investors, according to the market potential and purchasing power they project. Secondly, the two countries' economies have experienced rapid development ever since they started to open their markets to international trade through more liberal policies, China since the 1970's and India in the late 80's.

As can be seen from GDP levels, China has surpassed India while India has been experiencing more moderate growth, yet both countries still tell a story of rapid economic development over just a few decades. Growing markets would also logically attract FDI into both countries. Furthermore, both of them proved to be quite resilient to the economic crisis which hit most of the globe in 2008. The similarities of the two countries should minimize some of the problems which arise when comparing the level of FDI in different countries, thus most-similar case design is appropriate to be used here.

3.1 The Development of Foreign Direct Investment in China and India

Over recent years, the level of FDI inflow to China and India has been high when compared to the rest of the world. In 2016, both countries were in the top ten destinations for FDI inflows, China being the third and India the ninth (UNCTAD, 2017a, 12). In 2016, China attracted $170 557 million and India $44 458 million of FDI (OECD, 2017a). China has in fact attracted more FDI than India over the past decade, as is shown in Figure 2. Significant inflows of FDI started earlier in China, after they started to introduce economic reforms in 1978. On the other hand, it was only in the beginning of the 90's when India reformed its economy with the help of the IMF to be able to deal with severe balance of payments issues. Both countries have been gradual in their reforms, liberalising in a pragmatic manner, instead of employing shock-therapy as has been the case in post-Soviet states. In the next sub-sections, the development of FDI in the two countries will be analysed. A historical account of the liberalisation of economy in both countries will be provided first, to acknowledge the significant changes in the attitudes of the policymakers regarding FDI.

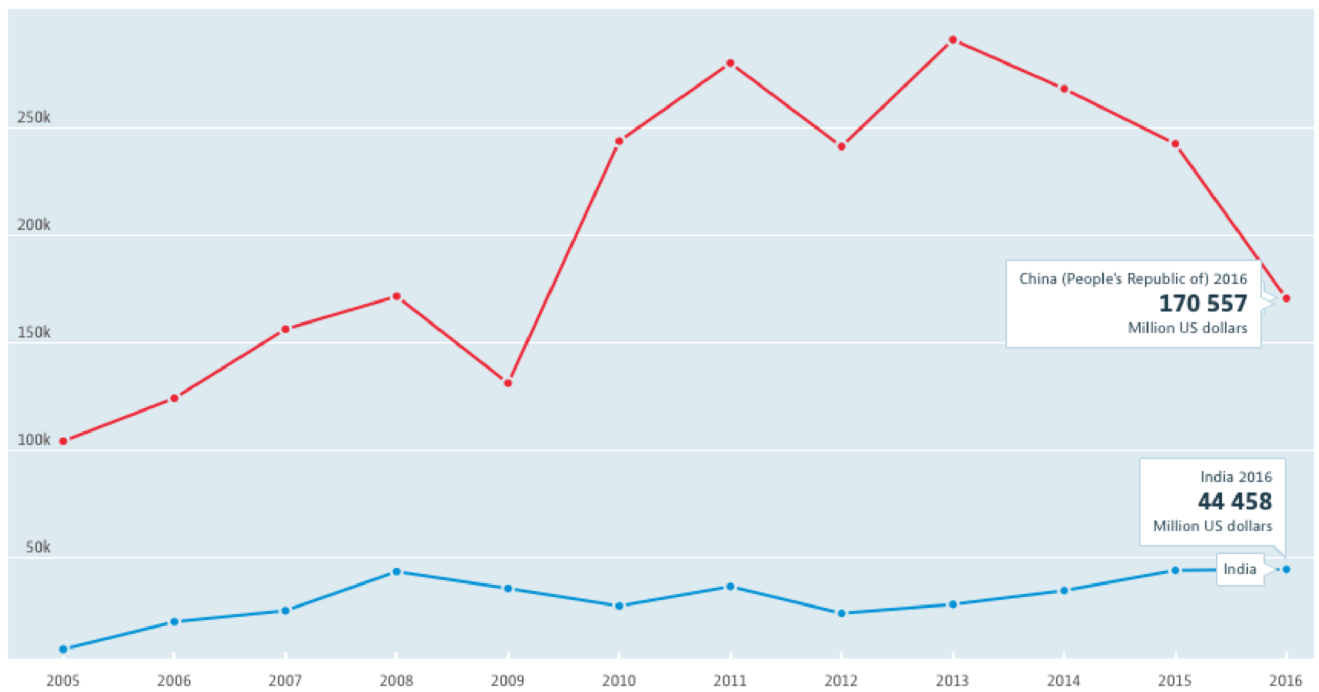

Figure 2. FDI inflows to India and China 2005-2016

Source: OECD, 2017a

3.1.1 The Development of Foreign Direct Investment in India

Before the liberalisation of markets gradually started in India in the 90's, the economy was largely closed-off from international trade. After gaining independence in 1947, the country adopted socialist-inspired policies to rebuild its economy towards self-sufficiency after being under the rule of the British for centuries. The economy relied on central planning, the currency was inconvertible and there were considerable barriers to imports. The growth rate of India at the time was modest at around 3%, and has been coined with the term "Hindu rate of growth" by Raj Krishna (Rodrik and Subramanian, 2004, 1). Nevertheless, scholars have pointed out that while economic development in India was modest, it was ordinary when compared to the rest of the world (DeLong, 2001, 2). Balance of payments problems started to accumulate in the 1980's, fuelled by the deterioration of the USSR and the peak in oil prices caused by the Gulf War. In the beginning of the 90's India was close to bankruptcy. The country turned to the IMF for assistance, and economic reforms were introduced to revive the economy.

Since the reforms in 1991, the Department of Industrial Policy and Promotion Ministry of Commerce and Industry has continued to amend the policies regarding FDI. Many industries now allow a hundred percent foreign ownership, including for instance defence, yet still excluding certain sectors such as banking and insurance much like China. Furthermore, the bureaucratic procedure for obtaining a license to operate was made simpler by making automatic approvals possible. When approval is needed, a deadline provides for speedy processing (Consolidated FDI Policy, 2017). Liberalisation has had a staggering impact on the level of FDI inflows, starting at modest $200 million in 1990, rising to $44.459 billion in 2016 (World Bank, 2016a). According to UNCTAD (2017a, 9), India is the third most prospective host economy for MNCs for the upcoming three years. However, as was discussed earlier, a prospective investment climate is not the single determinant for FDI. The political regime and its impact on FDI will be discussed below, in parallel to China.

While the change in policy climate has made a major contribution to the increase in FDI inflows, an additional factor was the shift in attitudes of the policy makers. Rodrik & Subramanian (2004) and DeLong (2001) argue that the change in the attitudes of the ruling politicians contributed towards India finally opening to international trade. On the other hand, N.K. Singh, an Indian politician who was involved in making the reforms of the 80's and 90s, directly challenged those arguments – "Even today, more than change in policies we are struggling with change in attitude.

The first reflex of any observer of Indian economy or potential foreign investor would be that while policies may not be so bad it is the attitude particularly of official ones which becomes the Achilles heel" (Quoteed in Panagariya, 2004, 4). There may be merit to both sides of the argument. There certainly needed to be a change in the attitudes of the politicians to start implementing the liberal policy reforms in the 80's and 90's, while perhaps partially being pressured by the IMF. However, the attitudes of some politicians and even the populace may continue to favour of more socialist policies.

3.1.2 The Development of Foreign Direct Investment in China

Much like in India, the liberalization of the Chinese economy has been done in a gradual manner. The first attempts to reform the centrally planned economy were led by Deng Xiaoping in 1978. Under Mao's rule, the country followed a strict socialist economic model based on high degree of state ownership and collectivization. After Mao's death, Deng presented a plan for reforms which would not abolish communism, but the economy would be more market-oriented and less government planned and controlled. The reforms were bottom-up in the sense that they were not implemented nation-wide at first. The initial reforms came in waves, the first dismantling the collectivization of agriculture and permitting foreign ventures. The second wave in the 80's and 90's allowed for privatization of some of the industries that had been under government ownership also abandoning control over prices and other protectionist measures. The reforms did not end after Deng's death in the 90's, as China has continued to introduce reforms to further allow privatization and there have been considerable reductions in bureaucracy and barriers to trade.

The impact the reforms have had on the Chinese economy are staggering. Brandt and Rawski (2008) state that the success of the reforms is visible in the fact that the Chinese economy has grown massively, hundreds of millions of Chinese were lifted from poverty, there is competition in most economic sectors and there has been a transition from isolationism to being well integrated in the global markets (21). The Chinese economy has indeed grown to be the second largest in the world (World Bank, 2016b). Furthermore, it is staggering that after having had an extremely closed economy prior to the open door policy reforms, it now attracts third most inflows of FDI in the world (UNCTAD, 2017a, 12), at $170.557 billion in 2016 (World Bank, 2016a).

As in India, the attitude towards foreign investment has changed drastically. China essentially had no foreign owned firms prior to the 1978 reforms (Wei, 1996, 78). However, the reforms of the late 70's included the adoption of the first ever law concerning FDI in the country, namely the Law on Joint Ventures Using Chinese and Foreign Investment (1979). Since then, the government has amended the law by liberalizing FDI even more. The 2017 amendment allows MNCs to engage in industries that were off-limits before. A few service-based industries were liberated, as well as high tech (National Development and Reform Commission and the Ministry of Commerce of the PRC, 2017) – indicating that China is trying to diversify the investments it is attracting. Currently 43% of all FDI is directed towards the manufacturing sector (Santander Trade Portal, 2017). The reforms are expected to have a stimulating effect on FDI and to be fair, like India, China is one of the most prospective countries for MNCs in the coming years of 2017 to 2019, being second just after the U.S. (UNCTAD, 2017a, 9).

3.2 How are Private Property Protection, Incentives, Credibility and Representation of Interests Facilitated in India and China?

3.2.1 Tangible and Intangible Private Property Protection in India and China

North and Weingast (1989) argued the most important thing for states to attract foreign investment is to provide institutional support for private property protection (PPP). Democracies are said to be well equipped to provide PPP because of the separation of powers, implying an independent judiciary. In India, the original constitution after independence recognized peoples' fundamental right to private property. However, a few years later the fundamental right to property was removed. As per the Land Acquisition Act, the Indian government can acquire land for public use, and in return provide compensation (Ministry of Law and Justice of India, 2013). The Act gives the government the possibility to expropriate and this certainly does not provide much merit to the argument that judiciaries in democracies provide for PPP against unfair government expropriation. As was stated, FDI projects involved large sunk costs, and thus the fear of expropriation is worrisome.

In general, acquiring and using land in India is ridden with bureaucracy, as explained by the International Trade Administration (2017b) – "To establish a business, various government approvals and clearances are required (…) register the land; seek land use permission if the industry is located outside an industrially zoned area; obtain environmental site approval; seek

authorization for electricity and financing; and obtain appropriate approvals for construction plans from the respective state and municipal authorities." Furthermore, according to the WB's Ease of Doing Business Ranking, India performs exceptionally poorly in the determinants of "dealing with construction permits", "registering of property" and "enforcing contracts". The overall ranking for India is 100 out of 190, whereas China has been placed 78th (World Bank, 2017). Hence, due to the fear of expropriation accompanied by the difficulty of acquiring land, it is fair to deduce that the democratic judiciary of India is not capable of providing stable protection of property.

FDI does not only require protection of tangible property, but intangible PPP is equally important. MNCs may have valuable knowledge or patents, which give then a competitive edge in the markets. Hence, Intellectual Property Rights (IPRs) need to be respected in the host country. IPs include patents, trade secrets and copy and trademarks. While India fulfils the minimal requirements for IPs protection as defined by the WTO in The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), it still struggles in this regard, for instance there is no law to protect trade secrets (The Law Library of Congress, 2015). According to the U.S. Chamber of Commerce's International IP Index, India ranks bottom third in the ranking of 45 countries (2017). It may be difficult to produce comprehensive evaluations as to how valuable are IP assets, but for companies that rely heavily on patents or their brand name, IPRs are vital.

The Indian experience largely refutes the argument, that democratic rule would best provide for private property protection. PPP is not simply achieved by having a separation of powers, nor by an independent judicial body keeping actors in check. Perhaps one of the major factors why India has not been able to catch up in terms of FDI with some of the other BRICS countries, is precisely the ineffective enforcement of the IPRs. Let us next look at China, and how it has facilitated protection of private property.

Before the 2007 Property Law of the People's Republic of China (PRC) came in effect, no codification of property rights existed. Like India, legal expropriation may take place ifit is done in the public interest. Furthermore, foreign investors are not eligible to buy real estate in China, only apply for a grant to use it (The State Council of the PRC, 2007). This has caused issues for foreigners – "Foreign companies have complained that Chinese courts have inconsistently protected the legal real property rights of foreigners" (International Trade Administration, 2017a). Hence the argument that expropriation may happen in authoritarian states, does apply in the case

of China. In effect, it has a negative impact on the perception MNCs have regarding the stability and reliability of China, in terms of PPP.

Upon its accession to the WTO in 2001, China also agreed to the implementation of TRIPS. However, like the India, China has had difficulties in enforcing the IPRs for foreign investors. According to the United States Trade Representative (USTR, 2017), one of the problems in China in terms of IPRs is the lax enforcement of sanctions against theft and misuse. Much like India, China has no trade secrets protection agenda and international patents are not fully respected, especially in the pharmaceutical sector (USTR, 2017, 9). When compared to India, China scores much better in terms of IP protection, being the 27th in the IP index ranking list of total 45 countries (U.S. Chamber of Commerce, 2017). Lately China has improved IPR protection, for instance in terms of patents. Godinho and Ferreira (2012, 501) point out that China filed an increasing number of patents. This leads them to believe that China is committed to patent protection to support the innovative sector of the economy. Indeed, in 2013, China initiated policies to diversify the economy and to attract FDI to new sectors. The Made in China 2025 initiative strives for innovation-led and value-added production, more investments in the service sector and quality over quantity (The State Council of the PRC, 2017).

The neo-institutional argument that institutions are best at providing PPP may be questioned for China. The country clearly has authoritarian characteristics and its institutions recognized to be untrustworthy because of the fear of expropriation and lax respect towards international IPR agreements. Nevertheless, the country attracts the highest inflows of FDI in the world. Chen (2015, 62) argues that contracts with local actors help MNCs to work around this issue. MNCs may form Subcontracting Manufacturing Factories (SMFs) with the local actors. The factory will have legal ownership and state-provided property protection because they formally are owned by the Chinese. However, the foreign investors acquire the right to manage the factory through contracts with the locals.

It is fair to assume that there are moral hazards related to such contracts – the local actors may take the investments hostage, especially since the investors have essentially no legal ways to safeguard their assets in this framework. However, Chen (2015, 64) argues, the contracts are rarely relapsed on because of the cultural nuances of China. The culture values long-term relationships with partners and mutual respect is expected. The signing of contracts with provincial actors suggests that MNCs themselves are facilitating PPP through unconventional ways. Hence, the argument

that the state and its institutions would be the most efficient protectors of property is challenged by the experience of MNCs in China. The cultural aspect of this is also quite interesting – it goes to prove that FDI interacts with states in unique ways and is determined by cultural characteristics as well.

3.2.2 The Credibility of China and India as Recipients of Foreign Direct Investment

Credibility of a regime was recognized to be an important issue affecting FDI. One isse affecting credibility is corruption. Corruption carries a normative connotation because it is morally questionable, but it also hampers credibility because it can jeopardize investors' assets and their reputation could be tarnished. On the other hand, corruption facilitates working around a cumbersome democracy and thus, provide for lucrative business opportunities for MNCs. The level of corruption is of great concern in China and India – According to Transparency International the countries ranked the 79th on a list of 176 countries in the Perceived Corruption Index (Transparency International, 2017).

Some studies show that corruption does not take the same form in China and India. According to Ravi (2015, 103) "In China though corruption is pervasive, arbitrariness is low. Whereas in India, arbitrariness is very high and what it means is one is not guaranteed of the result even after paying bribes. That partially explains why India's corruption has a detrimental effect on FDI, whereas in China, it has the opposite effect." Therefore, Chinese corruption itself may be more manageable for the MNCs because they can be assured that after paying the bribes, they can conduct their business as intended. This is not the case in India, if paying bribes does not guarantee the desired outcome.

China has taken a more active role in dealing with corruption. Xi Jingping launched an anti-corruption campaign in 2012 and as a result, thousands of officials have been investigated and disciplined (Xinhua News, 2017). The motivations of this policy may be both political and economic in nature. In all likelihood, it attempts to improve the tarnished reputation of the Party, control officials that have accumulated too much power and to improve the economy. The success of the campaign may be questioned as the "disciplinary" actions have been taken mostly against Party officials and not across the board, for instance businessmen and lower officials such as the police. The campaign has done little to target the root of the problem, and without doing so, corruption will continue to occur. What adds injury to the issue is the fact that there is no watchdog

in China to expose corrupt acts, since the media are heavily controlled by the state. While the lack of the fourth estate in not surprising because of China's authoritarian regime, democratic India is not doing much better. According to Freedom House (2017), Indian journalists face legal and violent threats, and their work is at times heavily censored. The press is only partially free. Furthermore, Indian politicians use the media actively to promote their cause and harming opponents, which renders the news outlets biased and of questionable trust.

3.2.3 The Incentives Provided by India and China

Theories argued that authoritarian regimes can provide more incentives for MNCs, because they are not constrained by the electorate to find a balance between foreign and domestic interest. China has been very successful in offering incentives for foreign investors, in the form of Special Economic Zones (SEZs). The SEZs are areas with more relaxed economic and financial regulations compared to the rest of the country. They are locally and not centrally managed, thus also decentralizing the economic responsibilities of the state. It should be noted that the SEZs vary greatly according to what kind of policies they utilize and which industries they specialise in. Nevertheless, it has been argued (Zeng, 2011) that SEZs have enabled the miraculous economic growth of China since they were established in the 80's in par with the other Open Door reforms.

The zones are pragmatic in the sense that when they were first established, it was to test liberal policies without completely opening the Chinese markets to international trade. The incentives include a high degree of PPP, lower corporate taxes accompanied by various tax breaks depending on the industry, and foreign ownership and commercial use of land is allowed. Wang (2013, 135) showed that the introduction of the SEZs has increased per capita FDI by 21 percent, hence the incentives has worked well. It is difficult to estimate the actual percentage of FDI that flows into the SEZs, but some estimate it to be around 50 percent of the total FDI inflows into China (Zeng, 2011, 14).

The SEZs and MNCs engaging in them have created employment and brought capital to China. This challenges the idea that when authoritarian countries resort to very competitive incentives to attract MNCs, they neglect the interests of the domestic populace. Furthermore, since China has implemented the incentives only in carefully chosen geographical zones, the domestic actors would not be exposed to the extremely competitive terms in other areas of the country. On the other hand, while there has been criticism towards the SEZs for instance in terms of wage levels

and working conditions, the fact remains that for instance Shenzen has grown from a small market town into a major production hub.

Many countries, India included, have looked to the example of China when setting up their own SEZs. India announced its SEZ policy in 2000, although there had been Export Processing Zones (EPZs) already in the 1960's. The EPZs had largely failed to encourage exports and the state decided to turn to SEZs. The Indian SEZs provide very low tax rates, exemptions and generous tax holidays (The Ministry of Commerce and Industry in India, 2017). FDI activities have concentrated only in a few regions – "The top six states namely Maharashtra, Delhi, Karnataka, Gujarat, TN Tamil Nadu and AP Andhra Pradesh have accounted for 70% of total FDI inflow during 2008-09 to 2011-12, whereas Maharashtra and Delhi together had more than 50% of FDI inflows" (Chakraborty et al., 2017, 626). These are the regions with the most SEZs as well. Hence, as in China, also the Indian SEZs have been successful in attracting FDI.

The Indian SEZs have struggled to reach the same level of success as the Chinese have. Some of the problems have been their concentration in only a few areas and their inefficient management. Rahoof and Arul (2016) point out that the benefits from SEZs, namely rise in employment, development of infrastructure and economic growth, only take place in the few states which host the SEZs (46). This is of course a difficult issue to tackle, sine FDI will continue to flow to the areas with the best infrastructure and tax incentives provided by the SEZs, thus leaving other areas less developed. This inevitably leads to discontent within the populace. Furthermore, Wysoczanska (2013) argued that the inefficient management of the Indian SEZs has been due to its political nature – the SEZs are managed centrally by the government, and the local officials have less power and responsibility. On the other hand, the Chinese central government largely gave local actors the power to manage the zones (Wysoczanska, 2013). It is fair to expect that if the management of the zones is from afar, efficiency suffers.

The quest to attract FDI has led both countries to use similar policies for the same ends. In this sense, regime type becomes largely irrelevant. China seems to have been more successful in implementing the policies to achieve economic growth and to attract FDI, however it also has advantages in terms of time. India turned to SEZs only in 2000, whereas China had been implementing the approach for a few decades by then. Furthermore, perhaps the decision-making in the authoritarian regime has provided for flexible and quick implementation of policies, whereas in India bureaucracy slows down the multi-levelled decision-making and there are numerous

competing voices which would stand to lose if reforms were to be made in the management of the zones.

Also cultural and ethnic ties play a role in making China and India attractive to investors. This is apparent when one looks at the origins of FDI inflows. In China, the top ten investors include Hong Kong, South Korea, Taiwan and Japan (Invest in China, 2017). The countries are within the same region and Taiwan and Hong Kong also ethnic and linguistic ties with China. It is fair to assume these countries have a cultural understanding of China and this gives them a competitive edge over rivals. On the other hand, what naturally would make dealings in India easier for foreign investors is the official status of English language. Regional FDI is not as strong in India as it is in China, but for instance investments from the UK amount to 15 percent of the FDI inflows (Reserve Bank of India, 2016). The long historical ties between the two countries has no doubt led to cultural convergence and there is understanding of the other's business culture. When it comes to cultural and ethnic determinants of FDI, regime type most likely has no effect on whether MNCs choose to invest. If the company is familiar with the operational side of business and can use this knowledge to its advantage, the political regime most likely makes no difference.

3.2.4 The Representation of Interests in India and China

The final condition which affected MNCs' decision to invest according to regime type was the ability of investors to express their interests in the host country amongst competing voices. According to theory, democracies hamper the efforts of the MNCs to influence because there are multiple channels and actors affecting the decision-making process. This can certainly be the case in India, being the largest democracy in the world with a population of 1.3 billion. For the time being, the government of Modi has strongly supported FDI friendly policies, as is apparent in the reforms he has introduced lately. However, the popularity of Modi's government is not guaranteed and was contested in 2016, when tens of millions of workers from the public sector joined in a general strike against his proposals to liberalize markets further (Safi, M. in The Guardian, 2016). As India is democratically governed, there is political volatility since the preferences of the electorate can quickly turn to more protectionist policies and consequently, lead the MNCs to be worse off.

One of the issues in India is the unequal distribution of FDI. Investment has been concentrated in clusters, mostly in the regions hosting the SEZs. As a result, the regions which have been less fortunate are also less open to the idea of liberalising markets to promote FDI. The politicians from these regions are myopic in the sense that they do not wish to see the long-term benefits FDI has. They are more concerned with being elected and hence, pressure the government to either redistribute the wealth or support more protectionist policies. Additionally, interest groups such as the Trade Unions, can pressure the government as was apparent in the 2016 general strike. Fighting off competing voices will certainly slow down the process of introducing reform. The long-awaited tax reform introduced in 2017 waited for ratification for almost two decades. Therefore, the argument that the competing voices in democracy hamper MNCs' efforts is sound when it comes to India.

On the other hand, being an authoritarian country, China does not in a similar sense have to balance the domestic interests with those of the MNCs'. Since the opening of the country to the global markets, China has pragmatically supported economic development by means of international trade and investment. If the country continues to hold this in high value, MNCs need not worry that the policy climate would change, even if domestic actors would want that. However, that just like domestic interests may be repressed by the regime, MNCs might also have a difficult time influencing the regime. Jensen (2006) pointed out that foreign lobbying is virtually impossible through formal mechanisms in China (79). However, in more recent years, foreign companies in China have turned to European and US interest groups, and they have lobbied for the collective interest of the MNCs, even though by law foreign industry associations are illegal (Weil, 2017, 2).

Given that there is virtually no history of interest group activity or lobbying in China, it is fair to expect that MNCs cannot effectively utilize their western-style lobbying schemes in the country. Therefore, it also makes more sense for the MNCs to collectively turn towards larger lobbying groups that may be more familiar with the Chinese lobbying culture and thus, have a fighting chance to advocate some of their policy goals. Weil concludes her research by saying that it is virtually impossible to know what is the degree to which the foreign lobbyists affect Chinese policymakers, because everything happens behind closed doors (2017, 236). However, the fact remains that China has started to listen to the international community more, as it has applied for instance stricter IPRs rules after its accession to the WTO.

CONCLUSIONS

The aim of this paper was to analyse the theoretical and empirical studies which have attempted to conceptualize the relationship between FDI and democratic and authoritarian regimes, to answer the research question of what type of political regime supports and attracts FDI more. The theories were shown to be inconclusive as they provided equally convincing arguments for both sides of the discussion. Some theories supported the idea that democracy provides for a transparent and credible investment climate, but simultaneously, many theorists argued that authoritarian regimes are equally capable of providing a stable investment climate. As the theoretical work did not provide a conclusive answer, the empirical studies were consulted. They however, were equally inconclusive in their findings.

Since we could not find an answer in the existing literature, an alternative way to study the subject matter was proposed – a detailed case study. Most-similar case design was applied to study China and India, justified by the fact that they display many similarities in terms of economic and geographical size, historical development of markets and keen interest in attracting FDI, while differing in terms of the independent variable of interest. The hypothesis was that a case comparison would show how the relationship between FDI and regime type take shape in the two countries, one being the largest democracy in the world and the other a one party authoritarian state.

The main result of the case study was that the relationship between FDI and regime type is more complicated than what the theoretical and empirical literature has suggested. While a more comprehensive methodological critique has been developed in a separate paper (Konki, 2017), as a summary it can be stated that it has failed to account for the spatial, cultural and time-sensitive details which affect FDI. A comparative case study of China and India showed that the relationship between FDI and political regime is not only determined by whether they are authoritarian or democratic, but also by historical, economic and cultural factors.

A key finding of this paper is that what matters most in the case of China and India is which policies they have introduced and how the policies have succeeded in the framework of their political regimes. It became apparent that authoritarian China has been more successful in introducing a policy framework that foreign investors find attractive. This is not only apparent in

the fact that China has attracted significantly more investment, but also in the way the two regimes have applied similar policies, such as the SEZs. China has implemented those more successfully when compared to India. This finding brings a new perspective to the scholarly discussion. While many of the theories have chosen to study regime, more attention should be given to study policy and how it affects FDI.

Furthermore, it is fair to say that in addition, this paper may provide policy advice to developing countries. Good Governance is often equated with liberal democracy and the idea is being exported from the west to the rest. For instance, the IMF bases its loans on conditionality, which essentially requires governments to adopt more democratic and liberal policies. It is believed that this ensures the sustainability of the economic stability and growth. However, as the Chinese experience showed, Good Governance policies of western design are not the only way to achieve economic growth nor to attract FDI. After all, foreign investment does not only flow to countries which have good governance in line with western views. Democratic institutions do not automatically mean successful policies for fostering FDI, and thus, the idea of Good Governance leading to sustainable economic growth may be challenged as well.

It was already suggested that more studies should be conducted on how FDI functions with different policies, and how said policies are implemented and constrained by political regimes. This would give a more comprehensive understanding of how countries can attract FDI. Furthermore, it is also suggested that more research should be done concerning hybrid regimes and FDI. This would take into account the fact that regimes and not static either – there is no single archetype of democracy of autocracy. Theorists cannot escape their subjectivity when they construct their theories and models, and this subjectivity also relates to how they have categorised states and regimes. For instance, the normative idea that democracy is intrinsically good may cloud the judgement of some and they will have a hard time remaining objective in their arguments. However, if the starting point for the study is that the regime type itself is an uncategorizable hybrid regime, there are less assumptions made when studying the subject matter. The existing literature is very polarised to discuss the pros and cons found in democracies or in autocracies – what about the regimes which fall somewhere in the middle?

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