“Foreign Direct Investment (FDI)”

Entry, Oxford Handbook of International Political Economy
Forthcoming (2020)

Rachel L. Wellhausen
Associate Professor, University of Texas at Austin
rwellhausen@utexas.edu

Citation:

1. Introduction: FDI as (victim of its) success

The concept known as foreign direct investment (FDI) is intended to capture economic activity in a given political jurisdiction, over which a foreign actor has meaningful managerial control.¹ International political economy (IPE) scholarship builds research agendas on the back of this concept. Statistical offices collect data on this concept. Sovereign states set policies targeting this concept. The United Nations publishes an annual World Investment Report on this concept, which the Secretary-General calls “an important tool for the international development community.”² In this piece, I probe why we have found it useful to separate this concept from all other forms of international economic activity. In so

¹ The international statistical standard is that meaningful managerial control exists when foreign ownership meets or exceeds 10 percent. There has been some discussion around raising the threshold; for example, in 2004, the IMF Committee on Balance of Payments Statistics recommended moving the threshold to 20 percent, although the IMF has not made this change (BOPCOM-04/31, from the Seventeenth Meeting, Pretoria, 26-29 October 2004). The OECD conforms to the 10 percent threshold for cross-border FDI transactions and positions, but it has put considerable effort into establishing definitions for foreign investments that do not meet that threshold (e.g. “Glossary of Foreign Direct Investment Terms and Definitions,” 4th Edition of the OECD Benchmark Definition of Foreign Direct Investment.)

doing, I highlight how the perhaps remarkable consensus over the parameters of this concept has underpinned major advances in IPE scholarship. I also select on scholarship published in just the last few years to provide evidence.\footnote{Cited literature is selected from recent journals and presses (2013-2019). A more extensive bibliography is available online, with thanks to UT Austin’s Innovations for Peace and Development research lab. This targeted strategy draws the reader to recent advances at the expense of highlighting the shoulders on which these advances sit.}

I then argue that FDI as a concept is in danger of becoming a victim of its own success. In my view, the major scholarly shortcoming in the field is that we too readily accept the usefulness of cutting international economic activity along the lines of “F,” “D,” and “I.” Scholars that question rather than accept the concept of FDI are unearthing compelling new answers to old questions. Moreover, scholars that question the concept of FDI are spurring creative research agendas on new questions. These efforts are picking up in both ‘scientific’ and ‘critical’ research traditions. As examples, I will highlight gains being made by probing the “F” in FDI. First, probing “F” has enabled a body of research that takes seriously the starting point that, say, American investors might be different from others investors in ways that shape the political economy of FDI. Second, much progress has been made from a common conceptualization of “F” as short-handing for large, productive, profit-maximizing multinational corporations (MNCs), but “F” also includes state-owned enterprise (SOE) activities abroad that fit uncomfortably within theories based on non-state actors. Third, sub-setting on “F” means that the impacts of “F” on domestic firms, and the political consequences, are included in studies of international economic relations only on the margins. I conclude with encouragement that, beyond the huge progress made due to de
facto agreement on the concept of FDI, scholars would do well to continue prioritizing research questions that critically engage with the concept.

2. **Contributions thanks to agreement on the concept of FDI**

A host state that allows foreign actors to own, operate, and profit from businesses in its geographical territory necessarily constrains the sovereign freedom of action otherwise reserved to it. Susan Strange’s turn of phrase “the retreat of the state” is born of the truism that in order to accept FDI at all, a state retreats (Strange 1996). This need not be the way the world works; the existence of FDI is a manifestation of political choices. It follows that political scientists have a particular comparative advantage over recognizing, and answering, questions arising from this starting point.

Literature that accepts FDI as a key, separate concept in international political economy reinforces how this starting point is different from that of trade, sovereign lending, portfolio investment, remittances, economic migration, foreign aid, and the myriad of other ways in which capital moves across borders. Especially in recent years, important contributions have highlighted the ways in which FDI impacts these kinds of other substantive areas of interest. For example, scholars have explored connections between FDI and central bank independence (Bodea and Hicks 2015); exchange rates (Egan 2017); sovereign debt (Wellhausen 2015a); portfolio investment and financial market development (Alzer and Dadasov 2013; Graham, Johnston, and Kingsley 2018; Pepinsky 2014; 2013; Pond and Zafeiridou 2019; Tomashevskiy 2015); aid and multilateral financial institutions (Biglaiser, Lee, and Staats 2016; Donaubauer, Meyer, and Nunnenkamp 2016; Dreher, Nunnenkamp, and Schmaljohann 2015; Ana C. Garriga and Phillips 2014; Malik and Stone 2018; Williams 2017); and illicit and informal economic activity (Beladi, Dutta, and Kar
A growing literature highlights how FDI and trade have intertwined political effects (Bowen and Elsig 2018), with respect to immigration (Kapur 2014; Mosley and Singer 2015; Peters 2014; 2017); treaties (Hicks, Milner, and Tingley 2014; Lechner 2018; Manger and Shadlen 2014; Osgood 2016; 2018; Osgood and Feng 2018; Pelc and Urpelainen 2015); and global value chains (Baccini, Pinto, and Weymouth 2017; Dallas 2015; Gereffi 2014; I. S. Kim et al. 2019; I. S. Kim, Liao, and Imai 2019; Pinto and Zhu 2016; Ravenhill 2014). Other work starting from the concept of FDI reveals further sectoral-level variation in the relationship between this kind of international economic activity and politics (Bogliaccini and Egan 2017; Bunte et al. 2018; Cheon 2019; Christensen 2019; Hughes 2013). For example scholars have examined the political consequences of the foreign firm's mode of entry (Broome, Homolar, and Kranke 2018; Lee, Biglaiser, and Staats 2014; Owen 2019; Pandya and Leblang 2017). Increasing attention has been paid to how often-mischaracterized foreign-owned business activity in services (Lakatos and Fukui 2014; Weymouth 2017), including the banking sector (Copelovitch and Singer 2017; Epstein 2014; Goyer and del Real 2014; Grittersová 2014; Iwanicz-Drozdowska, Bongini, and Witkowski 2018), challenge the theories built on the back of FDI characterized by fixed-asset investments (Kerner 2014; Kerner and Lawrence 2014).

These bodies of scholarship establish how FDI fits in the heterogeneous international political economy. They also set the stage for scholarship focused on the relationship between FDI and political institutions, processes, and outcomes. Work on the relationship between FDI and regime type continues (Arias, Hollyer, and Rosendorff 2018; Bak and Moon 2016; Bastiaens 2016; Frantz 2018; Jensen 2013; Li, Owen, and Mitchell 2018; Moon 2015; Tomashevskiy 2017; Wright and Zhu 2018). Importantly, the relationship of FDI and other
aspects of domestic politics are receiving increasing attention, in host states as well as home states. Important scholarship has challenged our priors on FDI and legislatures, labor power, and subnational politics (Jensen, Malesky, and Weymouth 2014; Owen 2015; 2013; Pandya 2014; Payton and Woo 2014; Pinto 2013; Samford and Gómez 2014); lobbying by not only industry associations but also individual firms (Brooks 2013; S. E. Kim and Urpelainen 2014; Töpfer 2017; Weil 2018). FDI’s effects on domestic public opinion (Mansfield and Mutz 2013; Shin and Lee 2019); and the implications of FDI for the fight against corruption (Cieślik and Goczek 2018; Malesky, Gueorguiev, and Jensen 2015; Pinto and Zhu 2016; Webster and Piesse 2018; Zhu 2017; Zhu and Shi 2019). Other work improves our understanding of how FDI as a specific part of the international political economy influences security, in host and home states as well as at the inter-state level (Barry, Chad Clay, and Flynn 2013; Barry 2018; Carter, Wellhausen, and Huth 2019; Ana Carolina Garriga 2016; Mihalache-O’Keef 2018; Vadlamannati, Janz, and Berntsen 2018). Of particular importance is work looking broadly at the impact of FDI on coordination at the inter-state level (Crasnic, Kalyanpur, and Newman 2017; S. E. Kim and Urpelainen 2014; Moehlecke 2019; Oatley 2019). Private commercial actors are driving international regulatory agendas and outcomes (Farías and de Almeida 2014; Farrell and Newman 2015; Kalyanpur and Newman 2019), at times substituting for classic government functions and creating alternative private governance institutions (Baron 2014; Doh et al. 2017; Fort 2015; Malesky and Mosley 2018). In the context of declining developed-country interest in international cooperation, these trends could fundamentally reconfigure international economic relations, in ways that IPE scholars have a comparative advantage in elucidating (Johns, Pelc, and Wellhausen 2019).
This brief review of key themes in research on the political economy of FDI demonstrates that, by isolating FDI among all possible international economic activity, scholars engage with the consequences of a particular political reality in which sovereign states allow foreigners to own and operate businesses in their geographic jurisdictions. While it need not be so, the political choice to accept FDI has been wildly popular in recent decades; scholars examine the ways in which politicians fall over themselves to attract FDI (Jensen et al. 2014; Jensen and Malesky 2018). Taken together, the wellsprings of FDI scholarship in both the ‘scientific’ and ‘critical’ research traditions accord with real-world interest as well as the pressing theoretical puzzles that FDI exemplifies.

3. **The shortcomings of agreement on the concept of FDI**

I now beg the reader’s pardon in articulating two lurking stereotypes of FDI research in the ‘scientific’ and ‘critical’ traditions. Scholars coming from a ‘scientific’ tradition might default to data-driven analyses of cross-national, time-series data sets of aggregate measures of FDI, dutifully correlated with political and economic covariates. On the other side, scholars from a ‘critical’ tradition might default to *dependencia*-inspired analyses of the adverse impact of multinational corporations (MNCs) on welfare outcomes in developing countries. My intention is not to debate the usefulness or accuracy of these stereotypes. Rather, notice how both stereotypical approaches (perhaps surprisingly) flesh out the original, barebones concept of FDI described above in very similar ways. These two stereotypes agree on the unit

---

4 Revolutions in quantitative methods, qualitative methods, and integrated mixed-methods research designs are raising the bar on the quality of evidence necessarily to substantiate arguments from either starting point. I should also acknowledge lurking defensiveness on my part, given that I have done work that can be collapsed into either stereotype.
of analysis underlying FDI: big, successful, profit-maximizing MNCs, with subsidiaries in a variety of host states, accountable to private shareholders in traditional capital-sending home states. Now, this particular unit of analysis is clearly consequential, to publics, policymakers, and scholars. In the ‘scientific’ tradition, cutting-edge research connecting heterogeneous trade theory (New New Trade Theory) to FDI establishes just how important such “superstar” MNCs are in the global economy (I. S. Kim et al. 2019; I. S. Kim, Liao, and Imai 2019). Research in the ‘critical’ tradition has long examined why “superstar” MNCs pose particularly consequential challenges to state power (Abdelal 2015; Sharman 2020; Skovgaard Poulsen 2015).

Nonetheless, new research agendas probe the extent to which the assumptions behind the “superstar MNC” wash away relevant variation in the actors engaging in FDI. With heterogeneity as a starting point, scholars are providing new answers to old puzzles, as well as identifying puzzles otherwise obfuscated by conceptual agreement on FDI – overlooked puzzles that, in my view, should be the target of more of our scarce research resources. By way of illustration, I focus here on scholarship that problematizes the “F” in FDI.

### 3.1 The home country of “F”

Is identifying an investor as “F” sufficient to understand outcomes in the international political economy? A long research tradition, in international business and elsewhere, has elaborated on the “liability of foreignness” – the ways in which it is exactly the point that, yes, outcomes differ because the firm is foreign (Alimadadi and Pahlberg 2014; Haftel and Thompson 2018; Newenham-Kahindi and Stevens 2018). A booming, interdisciplinary literature lays out the suite of political risk management strategies with which MNCs can
address this shared liability (Arel-Bundock, Peinhardt, and Pond 2019; Betz and Pond 2019; Jensen et al. 2019; Pond 2018).

Nonetheless, scholars are increasingly focusing on how the single category of “F” falls short in explaining many outcomes of practical and theoretical interest. For example, take the phenomenon of members of a diaspora abroad disproportionately investing in their home state. Scholars have grounded such real-world observations in theories about the advantages possible when “F” more closely approximates a domestic actor in the host state (Andrews, Leblang, and Pandya 2018; Dreher, Nunnenkamp, and Vadlamannati 2013; Fossati 2019; Graham 2014; 2019; M. Kim et al. 2015). Are there other ways that MNCs can limit or overcome liabilities by more closely approximating domestic actors? One promising area of IPE scholarship focuses on particular advantages for MNCs when the institutions of their home state match those in the host state, for example, when both home and host share similar levels of corruption (Beazer and Blake 2018; Godinez and Garita 2016).

Where exactly “F” is from can also be consequential – consider for example the political calculations made by Japanese MNCs versus others in, for example, China (Vekasi 2017). MNCs with different home states must manage different kinds of bilateral home-host state tensions, and they have access to different kinds of home-state-tied resources to draw on in case of conflicts, especially diplomatic support (Duanmu 2014; Gertz 2018; Gertz, Jandhyala, and Poulsen 2018; Wellhausen 2014). Yet home country diplomatic support for MNCs varies when they have, let’s say, complicated national origins (perhaps a strategically located headquarters in the Cayman Islands despite a different popularly-understood national identity), or when they engage in “round-tripped” FDI, in which the investor incorporates abroad and then invests back in the home state (Fichtner 2016; Moehlecke
2019; Wellhausen 2014). From the host state’s point of view, a diversity of MNC national identities shapes the tensions between FDI and sovereignty: if other “F” MNCs do not see the host state’s nationalization of, say, an American-origin MNC as a reason to abandon ship, the state can both exercise its sovereignty and play host to (some) FDI (Wellhausen 2015b; 2014).

Research agendas that critically engage with “F” are a particular priority, given the increasing importance of MNCs coming from the Global South (Collins 2013; Feldmann 2019). Scholars are rightly questioning whether the preferences we have attributed to MNCs are in fact specific to the Global North (Feldmann 2019; Huang and Zhu 2016). To push this research agenda, scholars might prioritize descriptive and critical work that documents how and when Global South-origin MNCs appear to be theoretical “outliers.” Such work can in turn spur needed systematic reevaluations of our expectations about the preferences of “F,” and under what conditions (if ever) they are uniform.

3.2 The owner of “F”

A compact characterization of the MNCs that comprise the standard unit of analysis in FDI research is that they are firms that “organize the production of goods and services in more than one country, involving the transfer of assets or intermediate products within the investing enterprise and without any change in ownership” (Jensen et al. 2012: 1). This definition does not precisely require MNCs to be profit-maximizers, but that is the standard ancillary assumption. This assumption serves us well in understanding, for example, the conditions under which profit-maximizing MNCs generate the kinds of economic growth, technological spillovers, employment, diversification, and other benefits that make host
states so eager to attract them in the first place (Pandya 2016a). Of particular importance in recent years has been the effort by IPE scholars to employ firm-level data when examining FDI, which is the most proximate point at which to link firm decision-making over profit-maximization and political economy outcomes. Notably, scholars are collecting and wrangling firm-level data in creative ways (Dorsch, Mccann, and Mcguirk 2014; Earle and Gehlbach 2015; Johns and Wellhausen 2016; S. E. Kim 2018; Malesky, Gueorguiev, and Jensen 2015; Markus 2012; Vadlamannati, Janz, and Berntsen 2018; Weymouth and Broz 2013). Novel data collection efforts are all the more important given the extensive shortcomings of standard time-series cross-sectional data sources (Kerner 2014; Linsi and Mügge 2019).

But what if MNCs are not profit-maximizers? The prominence of state-owned enterprises (SOEs) as actors in the international political economy begs this question. Today, there are many SOEs operating in domestic markets alongside privately owned firms, in developing and also developed countries, in industries like oil and gas but also in a variety of others. This reality contrasts starkly with the context of society-wide state ownership in which Cold War-era scholars considered SOEs. Particularly relevant here is the reality that SOEs also compete abroad; their investment flows are part of the FDI statistics that we use to motivate and test our hypotheses. How do our expectations born of profit-maximization translate when we engage with the kinds of outcomes state owners seek to maximize? Broadly, what does foreign state-ownership of an MNC mean for the push-and-pull between FDI and host state sovereignty?

As evidenced by a bevy of publications in just the last few years, interest in the political economy of today's SOEs is high. Clearly, the rise of China and Chinese SOEs acting
as foreign direct investors has inspired research that bucks the assumption that “F” means private (Cuervo-Cazurra 2017). Scholars examining natural resource politics and the phenomenon of Sovereign Wealth Funds (SWFs) also explicitly theorize around the effects of state ownership (Chwieroth 2014; Wang and Li 2016). Lurking behind this work is the potential trap that a finding interpreted as a result of state-ownership is in fact a finding on Chinese-nationality MNCs, or the oil and gas industry, or something else. Scholarship engaging widely with state ownership is thus an important complement to these research agendas. For example, scholars have linked SOEs participating in the global economy to trends in inequality (Avsar, Karayalcin, and Ulubasoglu 2013); conceptualized SOEs as a means of reinforcing domestic authority (Carney 2015); and considered what changes in state ownership (i.e. privatization or nationalization) mean for outcomes of interest (Bieler and Jordan 2018; Wellhausen 2014). Others start from the firm-level and explore the conditions under which state ownership generates different firm-level preferences and strategies (Cannizzaro and Weiner 2018; Cazurra et al. 2014). Impressive new data collection efforts improve our ability to characterize trends among MNC-SOEs as well as evaluate their successes and failures along metrics other than those of privately owned “F” (Babic, Garcia-Bernardo, and Heemskerk 2019).

### 3.3 “F” in the context of its domestic counterparts

As a last example, selecting on “F” means that IPE scholars working on FDI have prioritized research agendas studying “F” in isolation from its counterpart, domestic firms in the host state. To be fair, there is a compelling theoretical reason that often justifies setting domestic firms’ experiences aside: with “F” comes the benefit of a credible threat of exit that
is inaccessible to a domestic firm (Blake and Moschieri 2017; Farrell and Newman 2015; Wellhausen 2019). Nonetheless, given the practical importance of domestic firms to policymakers, their political importance to domestic publics, and the plethora of research questions orthogonal to variation in the threat of exit, ex ante excluding domestic firms from consideration limits progress (Bauerle Danzman 2020). Host state interest in FDI typically centers on what it can mean for the domestic economy, including of course existing and potential domestic firms (Bauerle Danzman 2019; S. E. Kim 2018; Klein 2019; Pandya 2016b; Skovgaard Poulsen 2015). Importantly, consistent scholarly effort goes into measuring the benefits FDI brings (or not) to domestic economic actors (Du, Harrison, and Jefferson 2014; Elliott and Zhou 2015; Merlevede, Schoors, and Spatareanu 2014). Expectations born of such analyses are a key input into host states’ decisions as to how and how much to open to foreign capital (Pandya 2014; 2013).

Some recent scholarship does takes up the challenge of considering “F” in context of domestic firms (Albertus and Gay 2019; Callaghan 2015; Hale 2015; Oladi, Beladi, and Gilbert 2014). For example, there is evidence that domestic firms enjoy relative advantages over foreign firms when, for example, they can leverage flexible organizational structures, or when the structure of their industry leaves more opportunities for small competitors alongside MNCs (Johns and Wellhausen 2020; Post 2014). Most prominently, scholars have embraced the domestic alongside “F” in one substantive area, where the relationship is unavoidable: the political economy of international investment law.

As it stands today, the property rights of those engaged in FDI are protected by what has become a de facto, spaghetti-bowl international regime codified in thousands of Bilateral Investment Treaties (BITs) and international investment agreements (IIAs) (Bonnitcha,
Poulsen, and Waibel 2017; Cho, Kim, and Lee 2016). A considerable amount of work by IPE scholars has gone into figuring out how much this de facto international investment law regime increases FDI, a question that in recent years has effectively morphed into whether there are any conditions under which international investment law actually has a demonstrable positive effect on FDI (Büthe and Milner 2014; Kerner and Lawrence 2014).

The most controversial piece of this de facto regime is Investor-State Dispute Settlement (ISDS), the somewhat opaque setting in which foreign investors can sue host states for compensation over treaty or contractual violations of their property rights (Hafner-Burton, Steinert-Threlkeld, and Victor 2016; St John 2018; Wellhausen 2016). In fact, the quest that began with identifying the positive impacts of international investment law has further morphed into identifying whether ISDS carries benefits for host states, particularly if and when they get sued (Blake and Moschieri 2017; Johns, Thrall, and Wellhausen 2019; Manger and Peinhardt 2017; Poulsen and Aisbett 2013; Wellhausen 2019)? Normatively disappointing answers to these questions are multiplied by other scholarly findings, such as the high costs developing country host states face as respondents in ISDS arbitration, and the difficulty of throwing off treaty commitments (Franck 2019; Haftel and Thompson 2018; Peinhardt and Wellhausen 2016; Thompson, Broude, and Haftel 2019).

One other characteristic of the de facto international investment regime is particularly relevant here: only foreign investors have access to these international legal institutions via which they can win compensation, directly from the host state, outside the domestic court system. Domestic firms do not have access to these protections. The implications of this imbalance, both normatively and in terms of the sustainability of ISDS as it is currently structured, have not gone unnoticed (Meunier and Morin 2017; Nichols 2018;
Simmons 2014). In fact, there is evidence that domestic firms prioritize financing from foreign investors that bring the firm not only capital but also access to international investment law (Betz and Pond 2019). I would offer that domestic firms are particularly uninterested in competing in a world in which they face a “liability of domestic-ness.” In choosing research priorities, IPE scholars would do well to remember again that “F” relies at the end of the day on a political decision to allow “F,” and that people working at domestic firms – and not foreign MNCs – are ultimately politicians’ constituents.

4. Conclusion

I ask the reader to keep two takeaways in mind. First, we understand the politics of economic integration more thanks to longstanding agreement on FDI as a unique source of constraint on host state sovereignty. It has been important and useful that much of the literature has de facto agreed to operationalize the unit of analysis underlying FDI as big, successful, profit-maximizing MNCs, with subsidiaries in a variety of host states, accountable to private shareholders in traditional capital-sending home states. The recent advances made by the huge body of scholarship born of this unit of analysis, from both ‘scientific’ and ‘critical’ research traditions, should not be overlooked.

Second, reconsidering the concept of FDI and its boundaries allows us an opportunity to uncover new answers to old questions in addition to reevaluating our priorities when it comes to our research agendas. In a world of scarce resources, I would prioritize scholarship probing “F” over scholarship that relies on the default conceptualization of the actors undertaking FDI. The same exercise can and should be extended to “D” and “I” as well. Is the longer-term, managerial control conferred by “D” always the politically relevant category in
a world of shareholders focused on quarterly earnings (Kerner 2014; Logvinenko 2019; Pandya and Leblang 2017)? On “I”: is investment really so different from trade in a world of intra-industry and intra-firm flows of goods and services (Baccini, Pinto, and Weymouth 2017; I. S. Kim et al. 2019; Mosley 2010; Peters 2017)?

These are research agendas that require classic constructivist skepticism; a ‘critical’ tradition does not mistake the way the world is for the way the world has to be. Political and social choices both in and out of academia have accumulated assumptions in building out the concept of FDI, and challenging those assumptions can be incredibly productive. These are also research agendas that will benefit from creative quantitative data collection efforts and empirical strategies in the ‘scientific’ tradition. In my view, the key issue going forward in the substantive area of FDI is to leverage comparative advantages in each research tradition to re-center work on where longstanding agreement on “F,” “D,” and “I” falls short.
References


83: 340–49.
Cazurra, Alvaro Cuervo, Andrew Inkpen, Aldo Musacchio, and Kannan Ramaswamy. 2014.


Hafner-Burton, Emilie M., Zachary C. Steinert-Threlkeld, and David G. Victor. 2016. “Predictability versus Flexibility: Secrecy in International Investment Arbitration.” *World Politics* 68 (3): 413–53.


Bars in International Investment Arbitration.” *Review of International Organizations*, July.


Malesky, Edmund J., Dimitar D. Gueorguiev, and Nathan M. Jensen. 2015. “Monopoly Money:


Wang, Di, and Quan Li. 2016. “Democracy, Veto Player, and Institutionalization of Sovereign Wealth Funds.” *International Interactions*.


