

**POLITICAL REGIME, COMPETITIVENESS, AND FOREIGN
INVESTMENT: AN EVIDENCE OF THE EURO AREAS' FDI POLICIES
TO SOUTHEAST ASIAN COUNTRIES**

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—Abstract—

Theory and previous evidences provide conflicting predictions concerning the growth effects of foreign direct investment (FDI). The mainstream ideas support FDI as an engine of employment, technological progress, productivity improvements, and ultimately economic growth. Because of these significant benefits, attracting FDI has become one of the integral parts of economic development strategies in many countries. There are two schools of thought that hypothesize the FDI determinants: economic factors and political factors. For the latter school of thought, the central questions are directed to determine whether political regime affect country's trade policy or not. In the advanced industrial countries where labour tends to be scarce, are left political regimes more protectionist than right ones, which represent capital owners? Prior evidence had demonstrated an association between the type of political regimes and trade policies (FDI policies).

This paper extends the cross-country and temporal variance in national policies of FDI. The theory looks at government partisanship, which we define in terms of left parties or right parties and contesting with global competitiveness index, which reflects the economics factors' school of thought. The paper tests two hypotheses that explore various aspects how the parties in Euro Area and Southeast Asian countries have competed over trade policy. This study uses Euro Area countries and Southeast Asian countries that actively do outward and inward FDI. The time frame of analysis is 2000-2006 period that is believed as a start of Economic Integration in the European Union, which is symbolized with the launching of European Single Currency at that time. Statistic methods used for testing the hypothesis are t-test and multivariate regression model.

The empirical results provide support for an intuitively positive effect of globalization that makes left parties and right parties converge on its political economy and preference into open or free trade, which is the main component of global competitiveness index. After controlling for various factors, political regime does not matter. In terms of position taking, both types of political regimes consistently take the free trade stances. In other words, it can be believed that Euro Area and Southeast Asian governments' preference on political economic and foreign investment are becoming more symmetric over time.

Key Words: *Political Regime, Foreign Investment, Competitiveness, Euro Area*
JEL Classification: F13 · F21 · G18 · P52 ·

1. INTRODUCTION

Since trade policy has significant effects that are predictable and observable, politicians are likely to be concerned about trade policy in their efforts to win elections. If so, parties should develop positions on trade policy that reflect their constituents' interests. As they do on other issues, parties should thus adopt positions on policy that reflect their overall ideological or partisan position in policy space. Studies of macroeconomic policy (both fiscal and monetary) have shown that such party differentiation occurs. Left-wing parties prefer policies that increase government spending and induce growth, while right ones favor policies that induce lower spending, more balanced budgets, and lower inflation.

These facts trigger an interesting question to investigate whether there is a noticeable difference among political parties in a country on their trade positions, especially, which are related to their policies on foreign trade in terms of foreign direct investment (FDI). Furthermore, this study asks whether this difference relates to some left-right ideological distinction among parties. Do left-parties advocate different trade policies or FDI policies than right-parties? In other words, can we use parties' positions on a generic left-right partisanship scale to predict their trade policy preferences?

Many theories about parties and trade policy respond negatively, predicting instead the convergence of parties' positions. In their investigation on 25 developed countries from 1945 - 1998, Milner and Judkins (2002) find that right-wing parties announce trade positions that favor free trade, meanwhile left-wing parties are more protectionist. Partisanship seems to have an important effect on trade policy, holding other factors constant. Pinto and Pinto (2006) find evidence of the existence of such partisan cycle of direct investment performance across countries and over time at the industrial level. Foreign investors seem to respond to partisan cycles: when parties of opposite ideologies alternate in power, FDI flows into those sectors where foreign capital is a component of the factor of production owned by the core constituent of the incumbent party, and out of those sectors where it substitutes for the factor owned by that constituent.

The research's main problem will be to analyze whether political parties compete over trade policy, especially the policy that is related to foreign direct investment in certain area. Therefore, the purpose of this research is to explore the concepts of partisanship and trade policy and their effects on foreign direct investment both in home countries (Euro Area countries) and in host countries (Southeast Asian countries). The study will be looking at the effects of political party type on foreign direct investment whether in home country or in host country at the time of certain political party type governs a country. In particular, this research tests a multivariate regression model of the relations between the orientation type political parties and foreign direct investment on a cross-sectional sample of 248 inward and outward FDI during the 7-years observation period.

2. LITERATURE REVIEW

2.1. Partisanship

A completely new field of economics opened up once Hibbs (1977) presents a model in which parties also behave “ideologically”. Winning elections is important, but only to the degree that it enables the party to “implement policies favoring their core constituencies”. This contrasting theory is called the Partisan Theory. It is argued that political parties, as organizers of broad coalitions of interests and ideas, have played a key role in the economic policy-making process. There is also wide agreement in the literature that governments controlled by conservative or social democratic parties have distinct partisan economic objectives that they would prefer to pursue in the absence of any external constraints. Socialist governments are expected to intervene extensively in the economy to modify market outcomes and redistributive wealth to favor the least advantaged sectors and advance equality in general. Conservative parties are generally assumed to develop less interventionist policies and to rely on market mechanisms to maximize economic growth and protect individual liberties.

According to the assumptions of the partisan model, which provide the initial foundation of this study, political parties adopt different economic strategies due to the latter’s redistributive effects of different combinations of unemployment and inflation lead left-wing and right-wing cabinets to choose different macroeconomic policies. In short, economic strategies respond to the concerns of the particular electoral constituencies that support the party in power. It emphasizes the fact that, besides responding to voter’s preferences, economic policies are employed to build electoral coalitions. According to Boix (1998), governments eventually have to choose between two alternative economic strategies to spur economic growth and sustain the competitiveness of domestic firms in the medium run. In one case, governments employ the public sector to raise the level of domestic savings and total investment and boost the productivity of capital and labor. In the other case, they rely on market mechanisms and private agents to maximize the rate of investment and thus foster economic growth.

2.2. Partisanship and Foreign Direct Investment

In context of the relationship between FDI and trade policy, theoretical arguments have made the two complement or substitute each other. Earlier theoretical efforts, like Mundell (1957), highlight the trade-substituting nature of FDI, and many recent efforts tend to favor FDI being trade complementing. As Petri (1995) and Pfaffermayr (1996) argue, however, the relationship is not predictable because the trade impact of FDI can be influenced by a range of factors, such as firm strategies, motivations for FDI, and government policies. Therefore, the relationship between FDI and trade policy remains a subject requiring empirical investigation.

According to Pinto (2005), FDI policies of OECD countries can be explained by looking at the left-right orientation of the government in power. A party's position on a unidimensional left-right ideological scale will have an important, predictable impact on its trade policy position. In developed countries, left parties should take positions more favorable to protection, and right ones should be more free trade-oriented.

What generates a party's preferred-policy position, especially on trade? Parties tend to locate themselves in terms of domestic political debates along some unidimensional left-right ideological spectrum in order to attract voters who harbor similar positions. A party's general ideological position arises from its historical position on a number of cleavages in society. For most OECD countries, a central cleavage around which they formed was class. Parties representing the working class fought their way into the system and into government in the late 19th and early 20th centuries. These left-wing parties typically reflected the class-based preferences of their core constituents, workers. In addition, as Lipset and Rokkan (1967) argued years ago, these old class cleavages persist in the party systems of today. Despite vast social, political, and economic changes, the party systems of the 1990s looked similar to those of the 1940s. Parties have been able to keep large bodies of citizens identifying with them over a long period of time and to renew their core clienteles from generation to generation.

The assumption that governments have partisan (and electoral) incentives in regulating economic activity is pervasive in the literature that explores the links between politics and macro-economic management: Hibbs (1977, 1992) and Tufte (1978) are the precursors in this tradition. Political parties build and nurture ties to

groups of voters, whether organized or not, and when in government tend to deliver policies valued by those groups for material (or ideological) reasons.

3. DATA, MODEL SPECIFICATION, AND RESULTS

The countries studied in this research are Euro Area countries, such as Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, and Southeast Asian countries, such as Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Although other Southeast Asian countries (and other emerging countries outside Asia) are also the recipients of FDI inflows from Euro Area countries, the five Southeast Asian countries considered here as the most stable democratic countries in that area.

The research carries out a multivariate regression to assess the relationship between government partisanship and FDI policies. The dependent variable is the FDI, and is defined as the natural logarithm of the annual FDI outflows and inflows of each country. Many studies have used FDI in measuring trade policy (Pinto, 2005; Pinto and Pinto, 2006). Milner and Judkins (2002) argue that FDI is a common and rational choice in investigating the effect of partisanship on trade policies, due to its characteristics that are strong tied to the government political economy. The natural log transformation of FDI is used to mitigate possible problems with the sample distribution of the amount of FDI.

Six sets of explanatory variables are included in an attempt to capture different effects. The first explanatory variable is the government partisanship variable. Since a country's FDI flow is likely to be affected by many factors other than the government partisanship, the remaining five sets of variables are included in an attempt to control for these other effects. These variables are used to "isolate" the effects of the partisanship on trade policy.

The first hypothesis proposes that left parties in Euro Area countries will prefer to apply trade policies that are favorable to protectionism (no-inward FDI). This first model is tested by regressing the dependent variable, \ln FDI outward against the home government partisanship (Euro Area countries) and control variables. To test for the hypothesized relationship between government partisanship and FDI policies in Southeast Asian countries (host countries), the Euro Area countries'

partisanship variable is augmented to the regression model. This second model is intended to test the second hypothesis that proposes left parties in Southeast Asian countries are likely to have trade policy that is more favorable protectionism, while right parties are likely to have trade policy that is more supportive of inward FDI.

Correlation analysis (Table 1) shows that some explanatory variables are significantly correlated. First, there is significant positive correlation between the EAPT (Euro Area Partisanship) and Openness variables (0.308), even though the correlation is quite small. This may be quite surprising since left wing governments normally are expected to be more favorable to protectionism or have negative relation with FDI outward policies. However, Garrett (1998) demonstrates that when left-wing parties control governments and labor market institutions are strongly institutionalized, they are associated with big traders.

Table 1: Coefficient Correlation of Hypothesis 1

Independent Variable	EAPT	GDPEA	OPENEA	EMPLOYEA	POPULEA	UNEMPLOYEA	GCIEA
EAPT	1.000	.138*	.308**	-.077	-.155*	-.048	-.081
GDPEA	.138*	1.000	.663**	-.623**	-.140*	.090	-.285**
OPENEA	.308**	.663**	1.000	-.203**	-.296**	.022	.031
EMPLOYEA	-.077	-.623**	-.203	1.000	.250**	-.104	.389**
POPULEA	-.155*	-.140*	-.296**	.250**	1.000	.040	-.421**
UNEMPLOYEA	-.048	.090	.022	-.104	.040	1.000	.017
GCIEA	-.081	-.285**	.031	.389**	-.421**	.017	1.000

Note: *p < 1%, ** p < 5%, *** p < 10%

The GDP and Openness variables are also positively correlated significantly (0.663). This statistic confirms the Euro Area countries' productivity, which suggests that the large portion of its GDP comes from its international trade activities. Romer (1989) posits the positive relationship between openness and economic growth as a stylized fact. On the other hand, in this investigation provides an interesting phenomenon that is contrary with common assumptions. Normally, it is said that bigger countries have more openness in its trade than small countries. A significant negative correlation between Openness and Population that represents country size (-0.296) support this phenomena. This implies that the small countries in Euro Area are able to optimize its productivity by having more international trade activities than the big ones.

Table 2 presents the regression results for the Euro Area countries' partisanship test (that is, Model I). As can be seen from this table, there is an interesting evidence of a positive relation between government partisanship and FDI outflow. The coefficient on the EAPT variable is positive, even though is not statistically significant ($t = 0.988$).

Table 2: The Effect of Euro Area's Partisanship on FDI Policies (Model I)

Variable	Coefficient	T-Statistic
Constant	-3.917*	-3.020
EAPT	.181	.988
GDPEA	.603*	2.696
OPENEA	1.392*	3.658
EMPLOYEA	2.257	.819
POPULEA	.321	1.547
UNEMPLOYEA	-7.951**	-2.573
GCIEA	.373**	2.278
MODEL		
F – value = 6.608*		
R – square = 0.162		

Note: * $p < 1\%$, ** $p < 5\%$, *** $p < 10\%$

This positive relation is different from the previous studies that suggest that left parties are favorable to protectionism. It seems that partisanship in the Euro Area countries does not have any effect to its trade policy or FDI policy. The GDP variable which proxies for country growth has a positive and significant coefficient (t-statistic = 2.696). This consistent with the investigation results of Grosse (1997) and Jensen (2006) that demonstrate countries with higher per capita GDP are expected to promote future MNC involvement, as growth is more sustainable. It also represents the wealth of a country or the ability to invest abroad. The positive and significant coefficient of Openness on FDI confirms the Euro Area countries' productivity, which suggests that the large portion of its FDI comes from its international trade activities, and it is supported by national competitiveness (global competitive index), which is correlated positively and significant with FDI.

Table 3: Coefficient Correlation of Hypothesis 2

Independent Variable	EAPT	SAPT	GDPSA	OPENSA	EMPLOYSA	POPULSA	UNEMPLOYSA	GCISA
EAPT	1.000	.134*	.019	.103	.002	.232**	.208**	.035
SAPT	.134*	1.000	.092	.071	-.034	.141*	.218**	0.58
GDPSA	.019	.092	1.000	.108	.157*	.152*	-.164**	-.072
OPENSA	.103	.071	.108	1.000	.059	.127*	-.082	.143*
EMPLOYSA	.002	-.034	.157*	.059	1.000	.276**	-.152*	-.043
POPULSA	.232**	.141*	.152*	.127*	.276**	1.000	.622**	-.073
UNEMPLOYSA	.208**	.218**	-.164**	-.082	-.152*	.622**	1.000	-.216**
GCISA	.035	.058	-.072	.143*	-.043	-.073	-.216**	1.000

Note: *p < 1%, ** p < 5%, *** p < 10%

The next stage of analysis involves testing the relationship as developed in the second hypothesis. It reveals that the coefficient on EAPT is negative but insignificant. The coefficient on SAPT is positive and significant.

Table 4: The Effect of Southeast Asian's Partisanship on FDI Policies (Model II)

Variable	Coefficient	T-Statistic
Constant	-.844	-1.037
EAPT	-.038	-.223
SAPT	1.029*	3.766
GDPEA	.591**	2.025
OPENEA	-.107	-.500
EMPLOYEA	-2.247	-.602
POPULEA	.085	.477
UNEMPLOYEA	12.821**	2.289
GCIEA	.172**	2.102
MODEL		
F – value	= 7.491*	
R – square	= 0.201	

Note: *p < 1%, ** p < 5%, *** p < 10%

This positive relation between partisanship in Southeast Asian countries and FDI policies is different from the previous studies that suggest that left-wing parties are favorable to protectionism. It seems that whatever ruling parties governing in Southeast Asian countries, those parties have a strong preference to attract foreign investment to accelerate the economic growth. In other words, these countries put economic growth goal above political preferences.

4. CONCLUSION

When analyzing the partisanship type of ruling parties that govern in Euro Area and its impact on trade policies, it can be concluded that government partisanship does not influence its FDI outflows into Southeast Asian countries. In other words, whether left-wing parties or right ones, both types support FDI outward and there is no any different preferences in define its political economy. Meanwhile, Southeast Asian governments' preference on political economic and FDI are becoming more symmetric over time (and the literature has shown that this is also true with respect to macroeconomic variables; the business cycles in the original ASEAN countries are becoming increasingly correlated). It does not matter what kind of party will take a rule, the government will always be more favorable to free trade or inward FDI.

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