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School of Management
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An Examination on Global Expropriation Episodes and Foreign Direct Investment

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Abstract

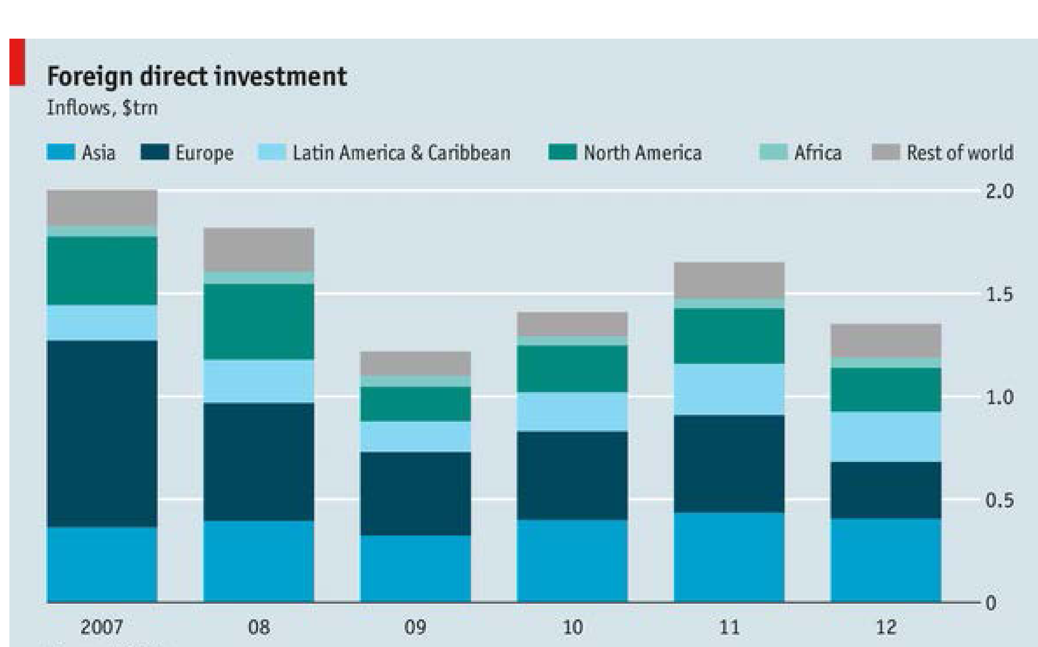
This preliminary study was conducted in order to determine whether or not expropriations directly impact a nation's investment climate and reduce the amount of FDI inflows that the country receives from foreign investors. The role of bilateral investment treaties in political risk, expropriations and FDI inflows was also examined. The preliminary results of the study have indicated that there does appear to be a connection between expropriations and the total volume of FDI inflows, as well as an impact of BITs on FDI inflows.

Key Concepts

Expropriation involves the seizure of privately owned property or assets by a government. Expropriation has been defined as the "forced divestment of equity ownership of a foreign direct investor" by a host government, with the divestment being *involuntary* (Minor, 1994).

Foreign direct investment (FDI) is a direct equity investment made in a foreign economy, in which a member of a foreign economy has control or significant influence over the management of a business entity in another country.

Bilateral investment treaties (BITs) allow lenders to seek legal protection in foreign courts for government expropriation acts, thus providing a form of insurance for investors. Because bilateral investment treaties provide certain protections to foreign investors, they are particularly advantageous to investors who are investing abroad in politically or economically risky regions.



FDI inflows vary greatly by world region based on levels of economic development and political risk

Hypotheses

Butler and Joaquin (1998)
Financial losses resulting from expropriation incidents or other types of political risks affect the value of a multinational corporation through changes in future cash flows and investors' required return.

FDI

H1: Government expropriations create a negative investment climate and act as a disincentive for FDI inflows into a particular country.

BITs

H2: Bilateral investment treaties help to encourage foreign direct investment activity.

H3: Bilateral investment treaties are more valuable when expropriation risk is greater. As such, the impact of BITs on FDI inflows is stronger in countries with a history of expropriation episodes.

Research Methodology

Data collection involved the use of online databases such as Factiva, identifying global expropriation incidents occurring between 1980-2015.

Identified expropriation incidents were compiled into a database containing variables including expropriating country, firm, industry, financial value of the expropriation and any legal settlements reached.

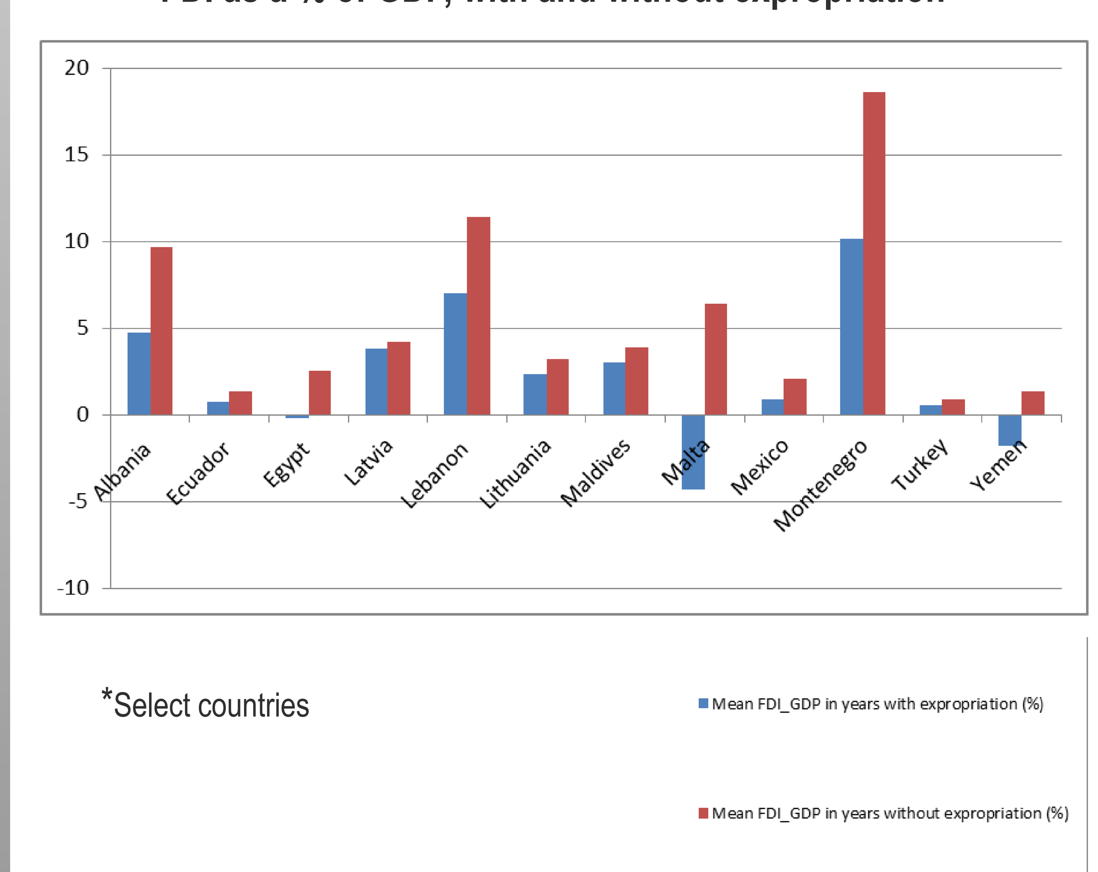
Regression analyses were performed based on the collected sample using SAS. The regressions utilized data variables for expropriating nations each year between 1980-2015 which included:

- FDI, net inflows (current USD)
- Gross domestic product (current USD)
- GDP per capita (current USD)
- Market capitalization of listed companies (% of GDP)
- Legal origin (i.e. common law, civil law, etc.)
- The existence of political crisis
- The cumulative number of BITs signed to date
- The cumulative number of BITs enforced to date

*Statistical data collected from the World Bank World Development Indicators (WDI) data repository

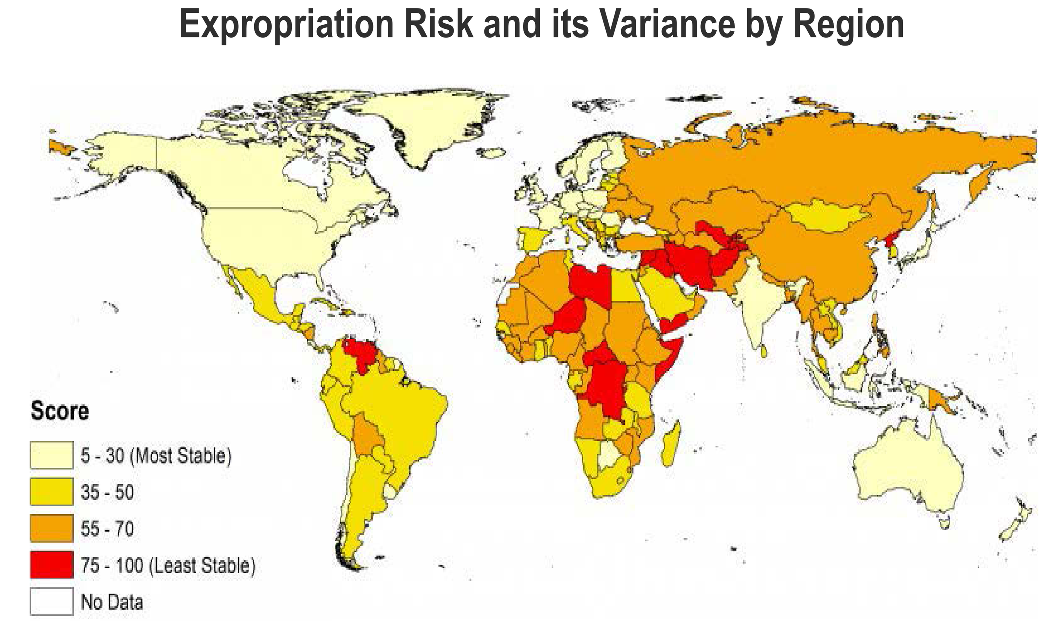
Regressions performed included a regression of the above variables of the study against expropriating nations' FDI inflows.

FDI as a % of GDP, with and without expropriation*



*Select countries

Expropriation Risk and its Variance by Region

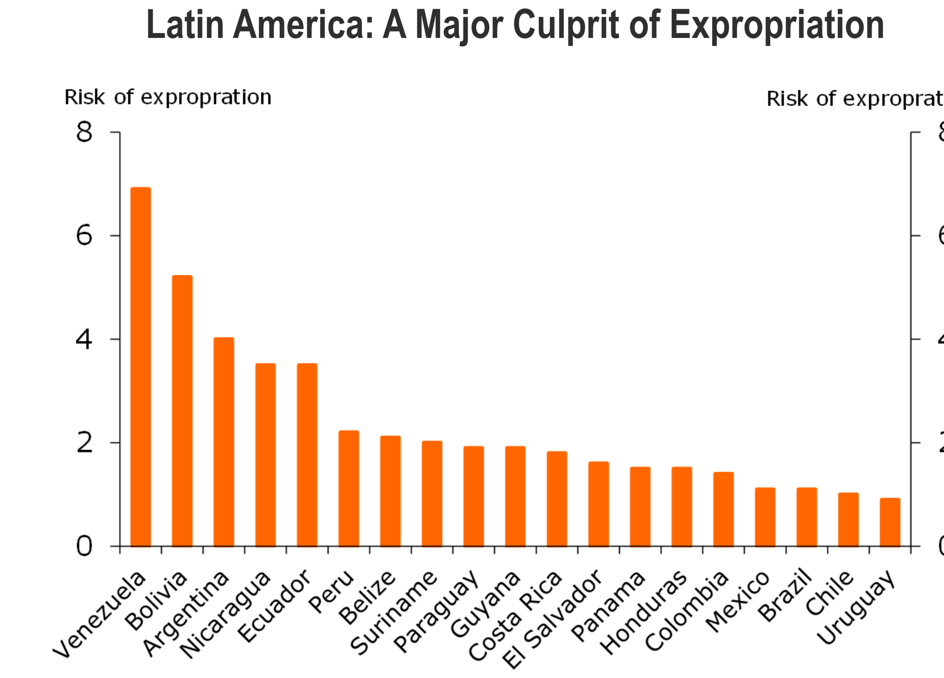


Research Findings

A significantly higher amount of expropriation incidents occurring between 1980-2015 were identified in Latin American nations, including Venezuela, Guatemala, Ecuador, Argentina and Bolivia. This trend of high levels of expropriation in Latin America has been demonstrated in empirical finance literature. Other nations outside of Latin America which tended to have higher expropriation incidents included Russia, the Ukraine, Uzbekistan, Kyrgyzstan and India. It is also important to note that, out of all of the above-mentioned countries, the only one which uses a legal system of common law origin is India, indicating that common law nations may be less susceptible to government expropriation acts when compared with other legal systems.

Nations which had relatively higher numbers of BITs signed were either developed nations or developing nations, such as Russia, the Ukraine and India. The other major expropriators identified by the study (Venezuela, Guatemala, Ecuador, Bolivia, Turkmenistan, and Kyrgyzstan) all had significantly lower number of BITs signed, indicating that BITs do in fact play a role in mitigating expropriation incidents. To further support hypotheses H2 and H3, the BIT data collected also indicated that many of the nations studied which had high levels of BITs signed and expropriated very *little* between 1980-2015 were *developed* nations mainly in Europe. Among these nations were Spain, Latvia, Lithuania, Malta, Croatia and Turkey.

Latin America: A Major Culprit of Expropriation



Conclusion

Overall, this preliminary study has indicated that there does appear to be a link between the presence of government expropriation and subsequent FDI inflows into foreign nations. Furthermore, regression analyses have indicated that there is validity to the role of bilateral investment treaties in positively affecting FDI inflows.