There seems to be a strong correlation between the rise of foreign direct investment (FDI) and the decline of territorial acquisitions by states. There also seems to be an inverse relationship between sovereignty and openness to foreign direct investment. Finally, there are tensions between democracy as a mechanism for popular control and the ease with which democratic leaders can deploy FDI for their own interests at the expense of popular welfare. This essay will consider these relationships.

Why do states no longer seek to conquer territory?[1] Erik Gartzke (2007) and others have explained this phenomenon by arguing that the modern equivalent of territorial control is market access. In short, states only conquered territory when that was the most effective way to avail themselves of its resources, and this pattern is said no longer to hold. However, even in recent years patterns have varied. Korbin (1984) analyzed expropriation in 79 developing countries from 1960 to 1979, observing a pattern of significant takeovers in the early 1970s and a decline thereafter. He argues that this pattern occurred because as the distance from the date of independence increased, technical and administrative capacity in the developing state also increased, and such states thus became more confident of their ability to achieve control indirectly through regulation, viewing direct control through expropriation as less efficient and effective. In more ambitious research, Frieden (1994) reinterprets colonialism as just one form of a cross-border contract between host countries and investors. The direct annexation characteristic of colonialism is particularly suited to investments with site-specific and easily-appropriated rents, such as mineral extraction and agriculture, but is less suited to other types of rent extraction. Frieden argues that variation will be driven by the ease with which rents accruing to investments can be appropriated by coercive means, as well as the difference between the next expected benefits of cooperation among home countries compared to the net expected benefits of unilateral action by a single home country. He stresses the correlation between the decline of colonialism and the coincident decline in the importance of primary investment in developing states and an increase in sovereign lending and foreign direct investment in manufacturing. He alleges without quite stating that these may be substitutes.

We might expect that democracies would welcome foreign investment. Like domestic investment, such resources enable a state to supply more jobs and pay more wages than would otherwise be possible. However, we must also consider that investors have many states from

[1] Crimea notwithstanding, direct annexation is significantly rarer than at any time in the past four centuries.

which to choose, and that they will be inclined to select the state that gives them the best deal. Li and Resnick (2003) studied the effect of democracy on FDI, finding that democratic regime type has both positive and negative effects on FDI levels. In a sample of fifty-three developing countries between 1982 and 1995, the authors conclude that property rights protection encourages FDI, democratic institutions improve property rights protection, but the effect of democratic institutions when controlling for this increase on property rights protection is negative. Democratic institutions seem to have both a positive and negative effect on FDI inflows in developing countries. The authors argue that "central aspects of democratic politics attenuate" the property rights effect by constraining foreign capital and constraining the host government (the authors do not speculate here, but the implication seems to be that a democratic host government will no longer be able to bend rules and provide favorable tax treatment). "While increasing levels of democracy help to produce better judicial systems and rule of law, these higher levels of democracy also drive foreign investors away by imposing constraints on foreign capital and the host government… While foreign investors may fear state exposure to popular will, they welcome restrictions on banditry provided by more democratic governments." (203). It seems that investors welcome the property rights protection but fear being asked to bear the local costs of (characteristically democratic) social services.

As we saw in the case of trade, the individual economic outcomes of foreign investment appear to drive individual attitudes towards FDI. Scheve and Slaughter (2004) identify a positive correlation between FDI in particular industries and perceptions of economic insecurity held by workers in those industries. Studying panel data from Great Britain between 1991 and 1999, the authors argue that FDI is the main source of worker insecurity generated by globalization (prior research had focused on trade shocks). The authors argue that FDI increases volatility, and that workers care about volatility in employment prospects as much as they do about absolute income levels. This finding holds even when considering only fixed effects on individuals, rather than across respondents. The key mechanism at work is said to be an increase in the elasticity of demand of employers in the presence of FDI, because FDI increases access to foreign factors of production.[2] Finally, the authors detect ambivalence towards FDI at the individual level, because multinationals both pay higher wages and (as a result of their relatively more elastic demand for labor) offer less reliable employment prospects. In similar research, Pandya (2010) found that FDI preferences are consistent with FDI's distributional effects. In a study of three years of public opinion data across 18 South American countries, Pandya found that support for FDI inflows increases in tandem with respondents' skill level, rejecting accounts based on populism and xenophobia – evidence of such behavior is apparently "the exception rather than the rule" (406). From a relatively thin base of data, Pandya draws profound policy conclusions, including that "any government efforts to expand education will have the additional payoff of building support for integration" (406). Leaving aside the questionable relationship between education and skills-building in Latin America, it is entirely possible that the relationship between FDI and skills is mediated by a third variable. For example, it seems plausible to suggest that belief in the efficiency of markets is a fundamental precondition for increased skills to translate to increased support for FDI at the individual level. While this support may well have turned up in the Latinobarómetro surveys in 1995, 1998 and 2001, these years may have been an exceptional zenith of market support in the countries surveyed – results from 1971 or 2021 might look quite different. Finally, both Scheve and Slaughter (2004) and Pandya (2010) make plausible claims whose external validity seems undermined by a meager evidentiary base.

In related work, Owen (2019) finds that the announcement of a new "greenfield" FDI project increases the probability that an incumbent party will win reelection. She studied Brazilian mayoral elections between 2004 and 2012, finding consistent support for this proposition. While this finding may seem obvious, it tracks similar research on "white elephant" projects in developing countries. Despite the long-term inutility of, say, an Olympic stadium or an airport with the capacity of Heathrow, such projects receive substantial support from local residents because the *construction* of such greenfield projects provides a fillip to local employment. This may be the mechanism at work behind Owen's results.

[2] Problematically, the authors equate all FDI with the "multinationalization of production," whereas the American experience suggests both that such FDI may take place via local investment vehicles and that the national origin of foreign capital matters a great deal. Also, it seems plausible that trade openness and openness to FDI are highly correlated.

States seeking higher levels of FDI are frequently tempted to offer investors explicit protection against expropriation, typically in the form of a bilateral investment treaty (BIT). Unsurprisingly, research indicates that such agreements only enhance investment in states which do not violate their terms.[3] More seriously, signing a BIT carries substantial implications for a state's sovereignty. Allee and Peinhardt (2011) find that while bilateral investment treaties (BITs) typically enhance the investment credibility of the contracting states, leading to an increase in FDI, such increased credibility is contingent on the subsequent good behavior of the contracting state. The authors studied the period 1972 – 2008, and excluded OECD countries as these states have established reputations for openness and infrequently resort to BITs to demonstrate their bona fides. In cases that come before the International Centre for the Settlement of Investment Disputes (ICSID), responding states suffer reductions in FDI, and if a state actually loses a case before ICSID, FDI falls yet further (though rebounding after three-to-five years). That states have reputations among investors, formed on the basis of their openness to foreign capital and protection of property rights, and that there are reputational costs for noncompliance, seems like an obvious finding. It would be interesting to know whether investor expectations are reset by a change in government, but this question is not addressed. The upshot of this research is that BITs do not universally increase the credibility of signatories, but that credibility enhancements are contingent on a government's continued compliance with the BIT.

Governmental attempts to attract investment are not limited to the international context, and the mechanics at work are broadly similar within states. Jensen et al. (2015) study the economic incentives (targeted tax deductions or exemptions) offered to business firms by states and localities in the United States between 1999 and 2012. They find that cities with elected mayors provide larger incentives and face less oversight than non-elected city managers, and that such mayors impose fewer qualification conditions on firms and deemphasize cost-benefit analyses. The authors attribute this gap to the exploitation by politicians of their information advantage over citizens, deploying this advantage for their own political gain even at substantial cost to the state or locality. "This kind of economic competition…provides a critical domestic

[3] If anyone has the capacity to engage in efficient Bayesian updating regarding the investor-protection credentials of developing states, it will be multinational investors. However, even these masters of the universe appear susceptible to groupthink and fashion – how else to explain repeated investor trust in Argentina over the past century?

political benefit to elected officials, which is an increased ability to pander for votes" (352). The authors do not deploy the term, but this is a classic instance of corruption, which the World Bank defines as the use of public resources to achieve private benefits. The potential for such corruption is particularly acute in democracies, but the tradeoff between sovereignty and investor protection should apply across regime types. Examining this issue, Simmons (2014) concludes that there is an unclear association between execution of bilateral investment treaties (BITs) and increases in foreign direct investment (FDI). She argues that many developing states that execute BITs are unprepared for the ensuing claims and demands for arbitration by investors. She finds a bias among arbitrators towards complaining firms and against states, and she points out that unlike trade agreements, BITs focus much more on protecting investors than on protecting states (this is presumably because states are sovereign entities capable of expropriating wealth within their borders, though this robust idea of the state sits uneasily with the picture of passive, long-suffering states that Simmons evokes). As she puts it, the present system of BITs "is great for investors but may be ill-suited to democratic governance generally" (42). There seems to be a tension between investor protection and the ability of states to regulate in the public interest. In her telling, a mechanism developed to allow investors to resist expropriation by dictators is now restraining the ability of democratically-elected governments to manage their own financial affairs. It seems problematic that this is precisely what such governments thought they were doing when they signed BITs.

It is worth noting that there are only two reasons why a state might sign an unfavorable BIT – incompetence or corruption. The agents of the state tasked with representing its interests can only undermine those interests by accident or on purpose – there is no other logical possibility. If such mistakes tend to be made by accident, there is a case for increasing state capacity. If they are made on purpose (to enrich present officeholders or favored constituents at state expense), there is a case for increasing oversight. In neither case can we simply blame the moral turpitude of investors, which Simmons seems eager to do. However, the case Simmons makes by aspersion is made elsewhere on a sounder basis. Zucman (2014) finds that the effective corporate tax rate of US multinational corporations[4] has dropped from 30 to 20 percent during the last 15 years. He finds that two-thirds of this decline can be attributed to increased profit-shifting to low-tax jurisdictions. Observing similar trends among individual and household wealth, Zucman makes the case for a world financial registry, redressing the loopholes in corporate tax and making personal tax evasion far more difficult. He argues that preference for bilateral tax treaties over a multilateral agreement has created "a web of inconsistent rules." His findings are shocking, and at present rates it seems that within a generation, US-based multinational corporations will pay no tax at all. Far from upholding the democratic practices of nations abroad, US-based multinationals are undermining American democratic practices at home. But as their CEOs would be the first to point out, such behavior is legal.[5]

A behavior's spurious legality is not necessarily connected to its efficiency. Caves (1971) pointed out that FDI is more common in some industries than in others. In particular, he points to situations of oligopoly with product differentiation as the most likely venue for FDI, as direct investment tends to involve market conduct that extends the oligopolistic relationship beyond national boundaries. If such oligopolies are able to entrench their domestic position through international expansion, the capitalist peace begins to look like a mirage, or at least more like a corporatist peace. Either way, the range of action of individual governments seems restricted. Vernon (1991) argues that governments are gradually becoming reconciled to a modified and substantially reduced concept of sovereignty in the economic field, driven by the increasing importance of multinational corporations to a state's domestic economy. This redefinition of national sovereignty has continued to develop in the 28 years since Vernon wrote, and the evolution of the European Union in particular seems to bear out his thesis. In this sense, we seem to be thrown back upon the past. The limited sovereignty of a Luxembourg or a Malta starts to look a lot like the pre-Westphalian sovereignty enjoyed by…Luxembourg or Malta. For such states, and for colossi like China and the United States, not much has changed. The total sovereignty enjoyed by mid-sized powers like France and Britain was always something of a

[4] This national citizenship is notional, not actual. Commissioner David Stern's explicit avowal last month that the National Basketball Association was at the end of the day an "American company" bound by American values is virtually the only admission of its kind in recent years (and was elicited by a strange and irreproducible series of events).

[5] They typically do not add that this legality is the direct result of their campaign contributions.

chimera – it was ultimately underwritten by the United States – but it is states like these whose understanding of sovereignty will have to change most dramatically.

I was intrigued by one of this week's discussion questions: is democracy good or bad for foreign direct investment? I'm inclined, like Simmons, to put the question the other way around. Unaccountable outside investment is a challenge to democratic processes and should be incorporated to the extent that it can be held accountable, but no further. The most deleterious effect on democracy, however, seems to me to occur in the source countries. Free movement of capital gives rise to a jurisdictional race to the bottom. This is a classic prisoner's dilemma, and can only be redressed through the intervention or empowerment of outside forces.[6] Ultimately, it seems likely that worldwide coordination along the lines of Zucman's proposed financial registry will come to be seen as a precondition for the movement of (unaccountable) capital across borders.

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[6] ICSID is clearly not the right forum.

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