
Can countries lobby for foreign direct investment? Evidence from the US

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Abstract: This paper empirically studies a mechanism where foreign direct investment (FDI) recipient countries lobby the US government for the allocation of outward US FDI. In this case, lobbying has the goal of informing US policymakers about their countries' market capabilities and of influencing their attitudes toward recipient countries. In turn, policymakers influence firms' decisions about the location of their potential investments abroad. We empirically estimate the direct influence of the recipient country's lobbying agents in obtaining FDI. The econometric results show that increasing foreign lobbying in the US raises the amount of US FDI received. This amount is potentially large for FDI receiving countries.

Keywords: FDI; foreign direct investment; lobbying.

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1 Introduction

The economic theory provides conflicting evidence on the economic growth effects of foreign direct investment (FDI). On one hand, FDI produces externalities in the form of technology transfers and spillovers (Romer, 1993). On the other hand, FDI may have a deleterious effect on growth by distorting the resource allocation (Boyd and Smith, 1992). Nevertheless, in general, governments take a positive attitude towards attracting FDI. In fact, governments compete for FDI with tax, subsidies and other short-run incentives (see for instance Wheeler and Mody (1992); see Blonigen (2005), for a review of the literature on the determinants of FDI; see Azman-Saini et al. (2010), for a recent study; see also Carkovic and Levine (2005), for a general discussion about the economic effects of FDI).

US international policy has a considerable influence on US private interests. For instance, US firms may find profitable to invest in Cuba, but US government restrictions impeded that. In a hypothetical situation, the Cuban government could lobby the US Congress to lift the embargo, and thus to free FDI for Cuba. Another example is US affairs in the Middle East and hypothetical promotion of FDI to boost development in countries that were isolated from Western investment in the past. This paper explores if potential recipient countries compete for FDI in the US using lobbying US policymakers. In this case, lobbying has the goal of informing US policymakers about their countries' market capabilities and of influencing their attitudes toward recipient countries. In turn, policymakers influence firms' decisions about the location of their potential investments abroad. We empirically estimate the *direct* influence of the recipient country's lobbying agents in obtaining FDI. That is, we study the effect of lobbying activities on US outward investment.

Our econometric results show that foreign lobbying in the US affects the amount of US FDI received. The unexplored link between lobbying and FDI may be of great importance for recipient countries and US firms.

This paper is organised as follows. Section 2 discusses foreign lobbying in the US. Section 3 presents the data and data sources. Section 4 presents the econometric results.

2 Foreign lobbying in the US

The Foreign Agent Registration Act of 1938 (FARA) provides a legal channel for foreign governments and businesses to lobby the US government and to influence the US public opinion. The main restriction is that such foreign 'principals' *must* hire an 'agent' based in the US. These agents may contact the US government or engage in a public relations capacity on behalf of the foreign principal. For simplicity, we assume that the principal and the agent share a common interest and refer to them as a single individual the 'lobbyist'. Moreover, we consider the US Congress as the only US government agency of interest. Through this FARA channel, lobbying by foreign governments and foreign businesses has become a large and thriving industry. Foreign lobbying is not necessarily the purview of rich countries, although it is positively correlated with the country's GDP per capita. A variety of rich and poor countries participate in lobbying activities through FARA channels. Moreover, it encompasses a wide range of activities, including lobbying those connected with the US government, lobbying the media, and incurring expenditures on promoting trade through advertising (Husted, 1991).

Using the FARA data, Gawande et al. (2006) study the impact of foreign lobbying on US protectionism and in a related vein, Kee et al. (2007) analyse whether South American lobbies succeeded in lowering US tariff preferences against those countries. In this case, foreign lobbying 'buys' reduction in a partner's protectionism. The rollback of US protection confers large rents to foreign exporters, and those exporters (via the help of FARA agents) initiate the lobbying efforts (see also the model in Gawande and Bandhopadhyay, 2000). Gawande et al. (2009) view foreign lobbying as informational lobbying with the intention of effectively achieving the goal of trade promotion in the context of Caribbean tourism. In this case, lobbyists compete on behalf of their clients for a large but finite pool of tourists. Montes-Rojas (2013) studies the effect of FARA lobbying on attracting US aid. See Facchini et al. (2011) for a recent study on lobbying and Grossman and Helpman (2002) for a survey and related theory.

This paper extends the analysis in the previous paragraph to FDI. The informational lobbying considered here follows the FARA studies where the US Congress decisions are affected by the common interests between the US and the foreign country, and that private firms in the US are greatly influenced by US international policy. Foreign lobbying may not have the direct purpose of attracting FDI and it is in fact done by a variety of agents (e.g., government agency, industry association, large private firms, ONGs) for a variety of reasons. However, on aggregate, these unrelated lobbying activities inform US policymakers about their countries' common interests in economic (trade, investment) or geopolitical terms. This new set of information from the lobbyists influences the decisions of US Congressmen, who in turn, encourage or discourage private firms to locate their business in different parts of the World.

Since many countries simultaneously compete for FDI, lobbying may potentially have two effects: first, it may increase the amount of resources available for foreign aid for all countries; and second, it may compete with other countries for a larger portion of a given amount of FDI. Of theoretical relevance is the question of whether lobbying competition among them may be used strategically by policymakers being lobbied to capture rents without benefiting any lobbyist. The ability of the policymaker being lobbied to take advantage of lobbying competition and corner the rents is well established in the case of *quid pro quo* lobbying (e.g., Grossman and Helpman, 1994), but it is not clear if it holds in the case of informational lobbying (Gawande et al., 2009). In the Grossman and Helpman (1994) model the policymaker's objective function explicitly trades off public welfare for lobbying dollars, since the policy distortion that lobbies want causes welfare loss. This sets the stage for cornering rents from lobbying competition since the policymaker can now economise on the distortions and yet maximise lobbying rents. In the informational case policymaker's objective may not contain such a trade-off at all. The policymaker loses nothing by using the information-provision by all lobbyists to update his priors and take the optimal (welfare-maximising or poverty-reduction) actions with respect to each of them separately.

3 Data

The variables' summary statistics are in Table 1 for the 55 countries used in the estimation of the next section. All variables are on an annual basis.

Table 1 Summary statistics

<i>Variable</i>	<i>Obs</i>	<i>Mean</i>	<i>Std. dev.</i>	<i>Min</i>	<i>Max</i>
ln(FDI)	2136	3.070	4.462	0.000	13.301
ln(Lobby)	2136	9.277	6.372	0.000	19.476
ln(GDP)	2136	23.417	2.240	18.454	29.300
ln(POP)	2136	15.555	2.0914	9.802	21.010
ln(X+M)	2136	20.702	2.549	12.386	27.329

The dataset used in the estimation of our empirical model was assembled using reports that FARA requires the US Attorney General to make available to Congress for the calendar

years 1997–2009. The report collects information about foreign agents operating within the US. A foreign agent, in the view of the US Department of Justice, is somebody who

- a engages in political activities or acts in a public relations capacity for a foreign principal,
- b solicits or dispenses anything of value within the US for a foreign principal, or
- c who represents the interests of a foreign principal before any agency or official of the US government.

Each entry in the FARA semi-annual reports contains

- i the name and address of the foreign agent
- ii the name of the foreign principal (usually an industry association or a government agency)
- iii the purpose of the agency, including any US government entities contacted
- iv amount of money paid to the agencies for their services.

We collect each data entry provided by the US Congress and record the money spend and the nationality of the foreign agent.¹ Finally, we aggregate all lobbying expenditures by year and country. The data obtained from the FARA registries shows that countries that lobbied the most are the largest countries (China, India, Russia, etc.) and those with the closest geopolitical ties with the US (i.e., Israel, Mexico, Colombia, Saudi Arabia, together with those that want to change their image in the US such as Venezuela and Libya). Lobbying per capita is higher for countries with geopolitical ties with the US (i.e., Colombia, Saudi Arabia). Countries that lobby do not necessarily lobby all years, and in general, different foreign agents from the same country may have entries in different years. In fact, different agents of the same nationality may lobby for different and even competing reasons.

US FDI is taken from the US Department of Commerce, Bureau of Economic Analysis.² GDP and population are taken from the World Development Indicators. US bilateral trade variables are obtained from the US Department of Commerce, Bureau of the Census, Foreign Trade.

Nominal variables are deflated to constant 2000 US dollars using the US GDP deflator and are used in logarithm. For *Lobby* and *FDI* we impute a value of 1 when the actual value is 0 to make the logarithm equal to 0 in those cases.

4 Empirical results

Our interest lies in evaluating the link between foreign lobbying and FDI. Consider a dynamic panel data model of the form

$$\ln(\text{FDI}_{i,t}) = \alpha \ln(\text{FDI}_{i,t-1}) + \beta \ln(\text{Lobby}_{i,t-1}) + \gamma X_{i,t} + \mu_i + \delta_t + \epsilon_{i,t}, \quad (1)$$

where i denotes country, t year, FDI foreign direct investment, $Lobby$ represents the FARA lobbying variable, X a set of additional control variables, and (μ, δ, ϵ) an error components model with country- and time-specific effects. Country fixed-effects are intended to capture

country's characteristics that cannot be controlled for using available covariates. Year fixed-effects capture the business cycle in the US and global events (such as 9/11), which affect the availability of resources and the US government preferences for their allocation. The dynamic specification is needed to account for persistence in the fund disbursement for multi-annual programs. The preferred specification uses one lag, but similar results are obtained with two lags. This model is valid if $|\alpha| < 1$. FDI series show strong persistence. The reason is that FDI may take several years for completion, and therefore, once a given flow of investment starts, they will continue for several years to come. We apply Levin et al. (2002) tests for unit roots in panel data models. For both FDI and Lobby we reject the null hypothesis of unit roots. In the model we include the lagged value of the logarithm of GDP, $\ln(\text{GDP})_{i,t-1}$, the logarithm of population, $\ln(\text{POP})_{i,t-1}$, and the logarithm of total bilateral trade $\ln[(X)_{i,t-1} + (M)_{i,t-1}]$.

In dynamic panel data models with unobserved effects, the treatment of the initial observations is an important theoretical and practical problem. As is well known, the usual within estimator is inconsistent, and can be badly biased. We thus follow the Anderson and Hsiao (1981) and Arellano and Bond (1991) strategy by taking first order differences and using lagged values of the dependent variable and other covariates in levels to instrument the autoregressive dependent variable. These instruments are also valid for other potential endogenous variables. Thus we also use instruments for all other covariates (except the year dummies).

Table 2 presents the econometric results. Column (1) shows the fixed-effects estimates. The coefficient of *Lobby* is not statistically significant. As argued above, the fixed-effects estimates are biased in short dynamic panels. We implement the Arellano and Bond (1991) and find a contemporaneous effect of 0.0336 using 1 lag as instrument, 0.0332 using 2 lags and 0.0174 (not statistically significant) using the full model. This is interpreted as increasing lobbying by 1% increases FDI flows by 0.03%. The long-run effects are more than double the static effect. The System GMM estimator, however, provides a value of $\alpha = 0.9788$ that is very close to 1 indicating that the level equation cannot be used.³ The validity of this econometric method depends on the suitability of the instruments, and this can be assessed from the tests. We report Hansen tests for over-identification restrictions and Arellano and Bond (1991) test AR(2) for second order serial correlation of the residuals. In all cases, the tests cannot reject the null hypothesis of validity of the this instrumental variables strategy.

Table 3 presents an alternative specification where the effect of lobby is interacted with the lag of FDI. This model accounts for the fact that lobbying may have a differential effect depending on the actual level of FDI. The effect of lobbying thus depends on the interaction of FDI in $t - 1$ and lobbying itself. In order to evaluate the effect of lobbying in this model, note that increasing lobbying by 1%, for $\ln(\text{FDI}_{it-1})$ being close to 0, increases FDI by 0.2% on average. This effect, however, reduces when FDI increases, indicating that lobbying is more effective to attract new FDI, rather than to increase existing FDI flows.

The results above suggest that lobbying is effective to attract FDI. Moreover, the effects are the largest for low values of FDI, which can be interpreted as a dynamic decreasing effect of lobbying.

Table 2 Effect of Lobbying on FDI

<i>Variables</i>	(1) <i>FE</i>	(2) <i>AB 1 lag</i>	(3) <i>AB 2 lags</i>	(4) <i>AB full</i>
$\ln(\text{FDI}_{it-1})$	0.443*** (0.0959)	0.505*** (0.129)	0.590*** (0.122)	0.707*** (0.0924)
$\ln(\text{Lobby}_{it-1})$	0.00936 (0.00938)	0.0336* (0.0179)	0.0332** (0.0131)	0.0174 (0.0107)
$\ln(\text{GDP}_{it-1})$	0.877** (0.362)	0.299** (0.135)	0.257** (0.117)	0.195** (0.0934)
$\ln(\text{POP}_{it-1})$	-1.421 (1.009)	-0.226* (0.125)	-0.181* (0.109)	-0.128 (0.0877)
$\ln(\text{XM}_{it-1})$	0.210 (0.153)	0.0501 (0.141)	0.0195 (0.122)	0.00364 (0.0889)
Observations	713	713	713	713
R-squared	0.485			
Number of id	55	55	55	55
Arellano-Bond AR(2) stat		1.752	1.678	1.709
AR(2) <i>p</i> -value		0.0798	0.0933	0.0874
Hansen stat		36.26	40.63	40.92
Hansen <i>p</i> -value		0.848	0.997	1

Robust standard errors in parentheses **p* 0.1, ***p* < 0.05, ****p* < 0.01.

Table 3 Effect of lobbying on FDI – dynamic effect

<i>Variables</i>	(1) <i>FE</i>	(2) <i>AB 1 lag</i>	(3) <i>AB 2 lags</i>	(4) <i>AB full</i>
$\ln(\text{FDI}_{it-1})$	0.679*** (0.0964)	0.761*** (0.0735)	0.828*** (0.0691)	0.964*** (0.0869)
$\ln(\text{Lobby}_{it-1})$	0.167** (0.0688)	0.265*** (0.0761)	0.233*** (0.0595)	0.220*** (0.0616)
$\ln(\text{FDI}_{it-1})\ln(\text{Lobby}_{it-1})$	-0.0179** (0.00750)	-0.0285*** (0.00868)	-0.0252*** (0.00670)	-0.0244*** (0.00713)
$\ln(\text{GDP}_{it-1})$	0.694** (0.321)	0.337** (0.136)	0.290*** (0.112)	0.213** (0.0854)
$\ln(\text{POP}_{it-1})$	-1.615 (1.057)	-0.323** (0.152)	-0.262** (0.125)	-0.186** (0.0917)
$\ln(\text{XM}_{it-1})$	0.200 (0.144)	0.180 (0.197)	0.129 (0.156)	0.0882 (0.105)
Observations	713	658	658	658
R-squared	0.500			
Number of id	55	55	55	55
Arellano-Bond AR(2) stat		1.801	1.771	1.768
AR(2) <i>p</i> -value		0.0717	0.0765	0.0770
Hansen stat		43.43	43.62	40.19
Hansen <i>p</i> -value		0.986	1.000	1

Robust standard errors in parentheses **p* < 0.1, ***p* < 0.05, ****p* < 0.01.

5 Conclusion

This paper explores a mechanism where FDI recipient countries lobby the US government for the allocation of outward US FDI. It uses aggregate data on lobbying on the US Congress, which needs to be properly recorded under the FARA act. The empirical results show a positive association between lobbying and FDI. This means that countries willing to attract FDI may increase the levels of inward investment by increasing their countries visibility in the US.

Further research is needed to investigate if specific lobbying activities are more successful than others for this purpose. For instance, the lobbying data can be disaggregated into private or public agents' activities and by industry. Moreover, the fact that countries compete for US outward FDI should motivate a complex model for the complementarities and competition among countries.

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Notes

¹Some entries are not specifically associated to a country but to a region. Examples of those are regional tourism association, such as the Caribbean Tourism Association. We opted to exclude this observations rather than imputing the countries that belong to this regions for three reasons. First, the imputation method (population or GDP or other) is arbitrary. Second, intra-regional bargaining power is unknown and may vary depending on the nature of the lobby. Third, US FDI varies on a country-basis rather than on a regional-basis.

²See <http://www.bea.gov/international/di1usdbal.htm> for an overview

³Not reported but available from the author upon request.